In 1986, Krause, through Special-T, began to perform consulting services for Titleserv on an hourly fee basis. Those services included the analysis of Titleserv's computer system requirements, and supervising its system's maintenance.

Based on Titleserv's needs, Krause realized that his services would expand to include creating computer programs for the mechanization of Titleserv's work flow. After discussions with Conway, Krause agreed to create those computer programs.

Krause, the programs' copyright owner,[1] granted Titleserv a license to use them. Under the terms of Krause's license, Titleserv was licensed to use Krause's computer programs and to possess a copy of the computer programs' executable files. Titleserv did not own a copy of the computer programs and did not have a license to modify them.

A few years later, Conway urged Krause to locate his Special-T office at Titleserv's premises. Under this new relationship, Titleserv effectively "outsourced" its computer department functions to Special-T. Krause identified and purchased hardware, selling it to Titleserv at a profit, designed and maintained a local area network, designed enhancements to Titleserv's word processing capability, developed computer aided marketing presentations, and developed computer programs for particular applications and thereafter modified or enhanced them as the need arose.[2]

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[1] "Copyright in a work protected under this title vests initially in the author or authors of the work." 17 U.S.C. § 201(a).

[2] At that time, Krause and Conway agreed that rather than the then current hourly fee arrangement, Special-T would receive a fixed

After several years, Conway requested Krause to assign the copyrights in his computer programs to Titleserv. Krause responded that he was willing to discuss the terms of assignments provided that he was adequately compensated for them. Months passed without Titleserv providing Krause with a written agreement to memorialize the terms that Krause and Conway discussed.

Krause thereafter learned that Titleserv wanted him to accept a subordinate position. Krause immediately informed Titleserv that this was unacceptable and, on July 10, 1996, he severed his relationship with Respondents. Nevertheless, Krause informed Titleserv that he was still willing to negotiate the terms of an agreement by which he would assign his copyrights to Titleserv.

Conway, however, had no intention to negotiate. On July 10, 1996, the same day that Mr. Krause voluntarily ended his relationship with Titleserv, Titleserv's remaining computer programmers started to decompile (reverse-engineer) the computer programs' executable files that Krause had licensed Titleserv to possess and use. The following day, Conway attempted to coerce Krause to provide "an assignment duly executed by you and your company of any and all copyright claims to the software." When threats failed, Conway caused Titleserv and Settlement to commence an action against Krause in the New York State courts. Conway succeeded in obtaining an order that required Krause to deliver his source code.

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annual consulting fee to be paid weekly. They also agreed that Special-T would service Titleserv as well as all of Krause's other customers, but, based on the payment of the annual retainer, Titleserv would receive services on a priority basis.

Since the district courts have original and exclusive jurisdiction in copyright cases,[3] Krause thereafter commenced this copyright infringement action in the United States District Court for the Eastern District of New York seeking damages and injunctive relief.[4]

After discovery, the Respondents moved for summary judgment. The assigned Magistrate Judge recommended that the district court grant summary judgment based on the affirmative defense set forth in 17 U.S.C. § 117(a)(1),[5] that provides:

> Notwithstanding the provisions of section 106, it is not an infringement for the owner of a copy of a computer program to make or authorize the making of another copy or adaptation of that computer program provided:
>
> > (1) that such a new copy or adaptation is created as an essential step in the utilization of the computer program in conjunction with a machine and that it is used in no other manner. . .[6]

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[3] 28 U.S.C. § 1338(a).

[4] Krause's action arose under the Copyright Act of 1976, as amended, 17 U.S.C. §§ 101, *et seq*. The District Court's subject matter jurisdiction over the action was based on 28 U.S.C. §§ 1331 and 1338(a).

[5] Pet. App., 55a. The Magistrate Judge also recommended against summary judgment on two additional bases that the Respondents' included in their summary judgment motion. The Respondents did not file Fed.R.Civ.P. 72 objections concerning those recommendations.

[6] The text of 17 U.S.C. § 117 is set forth at Pet. App. 64a-66a.

The district court, rejecting Krause's Fed.R.Civ.P. 72 objections, granted summary judgment based on the Respondents' Section 117(a)(1) affirmative defense.

The Court of Appeals for the Second Circuit ("Second Circuit") affirmed.

REASONS FOR GRANTING THE PETITION

The petition should be granted for several reasons. First, the Second Circuit's decision conflicts with other circuits' construction of Section 117. The Second Circuit's interpretation of "owner of a copy" conflicts with decisions of the Ninth and Federal Circuits; its interpretation of "created as an essential step in the utilization of the computer program in conjunction with a machine and that it is used in no other manner" conflicts with a Fifth Circuit decision.

Second, the Second Circuit's decision conflicts with holdings of this Court concerning the proper principles of statutory construction. Without any stated rationale, the Second Circuit defined "owner" in Section 117 in a manner wholly inconsistent with that same word in the Copyright Act's first sale doctrine, codified at 17 U.S.C. § 109. Moreover, the Second Circuit artificially replaced Section 117(a)'s word "essential" with the word "necessary." The court then found that the word "necessary" created an ambiguity in the statute.

Third, the Second Circuit's judgment destroys the balance that Congress struck in Section 117(a)(1) between copyright owners and software users. As a practical matter, the Second Circuit's judgment sets a new rule that legitimizes wholesale reverse-engineering and adaptions of licenced computer programs to the detriment of copyright owners.

1. The Decision Below Conflicts with Decisions of the Fifth, Ninth and Federal Circuits.

A. The Decision Below—in Setting Forth a New Definition of "Owner"—Creates a Conflict with Decisions of the Ninth and Federal Circuits.

Departing from other circuits that have addressed the issue, the Second Circuit held that an "owner" under § 117 need not possess "formal title." After dispensing with the "formal title" requirement, the Second Circuit concluded that Titleserv owned copies of Krause's programs within the meaning of § 117(a).[7]

(1) The Second Circuit's Rationale.

The Second Circuit set forth two policy bases to justify its holding that "formal title in a program copy is not an absolute prerequisite to qualifying for § 117(a)'s affirmative defense." The Second Circuit viewed that requiring formal title—that is frequently a matter of state law—would undermine a uniform national copyright law. The Second Circuit also thought it "anomalous" that a user, who could lawfully use a program forever or "throw it in the trash" could be "unauthorized to fix it when it develops a bug, or to make an archival copy as backup security."[8]

> Several considerations militate against interpreting § 117(a) to require formal title in a program copy. First, whether a party possesses formal title will frequently be a matter of state law. See 2 Melville B. Nimmer & David Nimmer, *Nimmer on Copyright* § 8.08[B][1] (stating that copy

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[7] Pet. App. 10a-12a.

[8] Pet. App. 10a.

ownership "arises presumably under state law"). The result would be to undermine some of the uniformity achieved by the Copyright Act. The same transaction might be deemed a sale under one state's law and a lease under another's. If § 117(a) required formal title, two software users, engaged in substantively identical transactions might find that one is liable for copyright infringement while the other is protected by § 117(a), depending solely on the state in which the conduct occurred. Such a result would contradict the Copyright Act's 'express objective of creating national, uniform copyright law by broadly preempting state statutory and common-law copyright regulation.' *Cmty. for Creative Non-Violence v. Reid*, 490 U.S. 730, 740, 109 S.Ct. 2166, 104 L.Ed.2d 811 (1989); see also 17 U.S.C. § 301(a).

Second, it seems anomalous for a user whose degree of ownership of a copy is so complete that he may lawfully use it and keep it forever, or if so disposed, throw it in the trash, to be nonetheless unauthorized to fix it when it develops a bug, or to make an archival copy as backup security.

We conclude for these reasons that formal title in a program copy is not an absolute prerequisite to qualifying for § 117(a)'s affirmative defense. Instead, courts should inquire into whether the party exercises sufficient incidents of ownership over a copy of the program to be sensibly considered the owner of the copy for purposes of § 117(a). The presence or absence of formal title may of course be a factor in this inquiry, but the

absence of formal title may be outweighed by evidence that the possessor of the copy enjoys sufficiently broad rights over it to be sensibly considered its owner.

We conclude that Titleserv owned copies of the disputed programs within the meaning of § 117(a). We reach this conclusion in consideration of the following factors: Titleserv paid Krause substantial consideration to develop the programs for its sole benefit. Krause customized the software to serve Titleserv's operations. The copies were stored on a server owned by Titleserv. Krause never reserved the right to repossess the copies used by Titleserv and agreed that Titleserv had the right to continue to possess and use the programs forever, regardless whether its relationship with Krause terminated. Titleserv was similarly free to discard or destroy the copies any time it wished. In our view, the pertinent facts in the aggregate satisfy § 117(a)'s requirement of ownership of a copy.[9]

(2) In Order to Affirm Summary Judgement, The Second Circuit Brushed Krause's Deposition Testimony Aside.

After disposing of Titleserv's lack of formal title as a bar to its Section 117 defense, the Second Circuit, in order to affirm summary judgment, had to eliminate the material factual dispute set forth in Krause's deposition testimony that Titleserv did not own a copy of the computer programs, During the examination concerning the terms of

[9] Pet. App. 9a-11a.

Krause's license to Titleserv, Krause answered "No" to the question "When you left on July 10, 1996, did Titleserv own the copies of the executables?"[10]

The Second Circuit dismissed Krause's deposition testimony—that responded to Respondents' factual inquiry concerning the license's terms—as a "conclusory assertion on an issue of law."[11] In doing so, the Second Circuit improperly inferred that Krause provided a conclusory legal assertion, rather than a factual answer to a direct question about the specific terms of the license that he granted to Titleserv.[12]

(3) The Ninth Circuit Conflict.

The Ninth Circuit examined the issue in *MAI Systems Corp. v. Peak Computer, Inc.*[13] In *MAI Systems*, MAI formerly manufactured computers and designed operating system software to run those computers. It continued to service its computers and software.[14] Peak maintained MAI computers for more than one hundred of its clients. Its services included routine maintenance and emergency repairs. It was sometimes necessary for a Peak technician

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[10] Pet. App. 12a.

[11] *Id.*

[12] *See Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 255, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986) (all ambiguities must be resolved and all inferences drawn in favor of the party against whom summary judgment is sought).

[13] *MAI Systems Corp. v. Peak Computer, Inc.*, 991 F.2d 511 (9th Cir.1993), *certiorari dismissed*, 510 U.S. 1033, 114 S.Ct. 671, 126 L.Ed.2d 640 (1994).

[14] *Id.*, at 513.

to operate the computer and its operating system software in order to service an MAI computer.[15]

MAI licensed its customers to use the software, which use necessarily included copying the software into the MAI computer's random access memory ("RAM"). However, the licenses did not authorize third parties, such as Peak, to copy the software. As set forth in MAI's licenses, "Any possession or use of the Software . . . not expressly authorized under this License . . . is prohibited . . ." Therefore, when a Peak technician serviced an MAI computer, the act of operating the computer constituted an unauthorized duplication of the software from the hard drive into RAM in violation of the Copyright Act.[16]

After concluding that "Peak's loading of copyrighted software into RAM creates a 'copy' of that software in violation of the Copyright Act," the Ninth Circuit found that Section 117's affirmative defense did not shelter Peak because Peak's customers did not own copies of MAI's software since their possession of the software was dependent on an MAI license. "Since MAI licensed its software, the Peak customers do not qualify as 'owners' of the software and are not eligible for protection under § 117."[17]

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[15] *Id.*

[16] *Id.*, at 517.

[17] *Id.*, at 518-19 and footnote 5. MAI has been unfairly criticized. *See, DSC Communications Corp. v. Pulse Communications, Inc.*, 170 F.3d 1354, 1360 (Fed. Cir. 1999) ("The Ninth Circuit stated that it reached the conclusion that Peak was not an owner because Peak had licensed the software from MAI. . . . That explanation of the court's decision has been criticized for failing to recognize the distinction between ownership of a copyright, which can be licensed, and owner-

(a) After MAI Systems, Congress Provided a Safe Harbor to Independent Computer Service Technicians.

In 1998, Congress amended Section 117 by adding an infringement defense for independent service technicians who, like Peak, would otherwise become liable for copyright infringement merely because they turned on a machine in order to service its hardware components.[18] Explaining the amendment, and citing MAI Systems, the Senate Judiciary Committee stated:[19]

> Title III of the bill amends section 117 of the Copyright Act (17 U.S.C. 117) to ensure that independent service organizations do not inadvertently become liable for copyright infringement merely because they have turned on a machine in order to service its hardware components.
>
> When a computer is activated, that is when it is turned on, certain software or parts thereof (generally the machine's operating system software) is automatically copied into the machine's random access memory, or 'RAM'. During the course of activating the computer, different parts of the

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ship of copies of the copyrighted software." (Internal citation to *MAI* omitted)).

But MAI's license demonstrates that MAI licensed both the copyright in its computer programs and the software's possession. "Any *possession* or use of the Software . . . not expressly authorized under this License . . . is prohibited . . ." *MAI*, 991 F.2d at 517 (emphasis added).

[18] Pub. L. No. 105-304, 112 Stat. 2860, 2887 (the Computer Maintenance Competition Assurance Act) added 17 U.S.C. § 117, subsections (c) and (d). See Pet. App., 65a-66a.

[19] Senate Rep. No. 105-190 (May 11, 1998), pp. 21-22.

operating system may reside in the RAM at different times because the operating system is sometimes larger than the capacity of the RAM. Because such copying has been held to constitute a 'reproduction' under section 106 of the Copyright Act (17 U.S.C. 106),[21] a person who activated the machine without the authorization of the copyright owner of that software could be liable for copyright infringement. This legislation has the narrow and specific intent of relieving independent service providers, persons unaffiliated with either the owner or lessee of the machine, from liability under the Copyright Act when, solely by virtue of activating the machine in which a computer program resides, they inadvertently cause an unauthorized copy of that program to be made.

This title is narrowly crafted to achieve the foregoing objective without prejudicing the rights of copyright owners of computer software. Thus, for example, 1201(k) does not relieve from liability persons who make unauthorized adaptations, modifications, or other changes to the software. This title also does not relieve from liability persons who make any unauthorized copies of software other than those caused solely by activation of the machine.

[footnote 21]: See *MAI Sys. Corp. v. Peak Computer*, 991 F.2d 511 (9th Cir. 1993), *cert. denied*, 114 S.Ct. 671 (1994).

(4) The Federal Circuit Conflict.

In the decision below, the Second Circuit cited the Federal Circuit's decision in *DSC Communications Corp. v. Pulse Communications, Inc.*[20] for the proposition that "courts have attached less importance to formal title, looking rather at the various incidents of ownership."[21] In *DSC Communications*, the Federal Circuit held that the Regional Bell Operating Companies ("RBOCs") were ineligible for Section 117's defense because they did not own the copies of the software that they transferred regularly onto interface cards.

The Federal Circuit based its conclusion on license restrictions that prevented the RBOCs from transferring copies of the software.

> Each of the . . . agreements limits the contracting RBOC's right to transfer copies of the . . . software . . . Such a restriction is plainly at odds with the section 109 right to transfer owned copies of software to third parties.[22]

The first sale doctrine, codified in 17 U.S.C. § 109 provides, in pertinent part, that an "owner of a particular copy . . . lawfully made under this title . . . is entitled, without the authority of the copyright owner, to sell . . . that copy . . . ."[23]

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[20] 170 F.3d 1354 (Fed. Cir.), certiorari denied, 528 U.S. 923, 120 S.Ct. 286, 145 L.Ed.2d 240 (1999).

[21] Pet. App. 8a.

[22] *DSC Communications*, 170 F.3d at 1361.

[23] *See* Pet. App. 60a-61a.

Unlike the Second Circuit, the Federal Circuit recognized that the indicia of ownership of a copy in Section 117 must be consistent with a copy owner's rights under the Section 109 first sale doctrine. Any possessor that is not an owner for Section 109 purposes cannot be an owner under Section 117. The Respondents here, like the RBOCs in *DSC Communications*, lack the authority to sell the copies of computer programs.

B. The Decision Below—In Condoning Non-Essential Adaptions—Conflicts with the Fifth Circuit's Decision in *Vault Corp.* v. *Quaid Software Ltd.*

The decision below conflicts with the Fifth Circuit's decision in *Vault Corp. v. Quaid Software Ltd.*[24] concerning the meaning of Section 117's language "created as an essential step in the utilization of the computer program in conjunction with a machine and that it is used in no other manner."

Vault produced PROLOK computer diskettes that prevent the unauthorized duplication of programs placed on them by software computer companies. Quaid produced diskettes, with a feature called RAMKEY, that unlock PROLOK diskettes' protective device and facilitate the creation of a fully functional copy of a program placed on a Vault PROLOK diskette. In order to develop RAMKEY, Quaid copied Vault's PROLOK program into the memory of its computer and analyzed the manner in which the program operated.[25]

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[24] *Vault Corp. v. Quaid Software Ltd.*, 847 F.2d 255 (5th Cir. 1988).

[25] *Id.*, at 256-57.

Vault argued that the unauthorized copy that Quaid loaded into its computer's memory constituted an infringing duplication in violation Vault's copyright. Vault theorized that Section 117(1)'s "and that it is used in no other manner" language limited the defense to "copying . . . a computer program for the purpose of using it for *its intended purpose*." Since the PROLOK computer diskettes' purpose was to prevent unauthorized duplication of programs, Vault urged that Quaid's act of copying Vault's program into its computer's memory for a different purpose—devising a means of defeating PROLOK's protective function—rendered the Section 117(1) defense inapplicable.[26]

The Fifth Circuit rejected Vault's notion. In discussing the purpose of Section 117(a)(1), the court stated that "Congress recognized that a computer program cannot be used unless it is first copied into a computer's memory, and thus provided the § 117(1) exception to permit copying for this essential purpose."[27] Continuing, the court stated:

> Even though the copy of Vault's program made by Quaid was not used to prevent the copying of the program placed on the PROLOK diskette by one of Vault's customers (which is the purpose of Vault's program), and was, indeed, made for the express purpose of devising a means of defeating its protective function, the copy made by Quaid was 'created as an essential step in the utilization' of Vault's program. Section 117(1) contains no language to suggest that the copy it permits must be employed for a use intended by the copy-

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[26] *Id.*, at 261.

[27] *Id.*

> right owner, and, absent clear congressional guidance to the contrary, we refuse to read such limiting language into this exception. We therefore hold that Quaid did not infringe Vault's exclusive right to reproduce its program in copies under § 106(1).[28]

Thus, the Second Circuit's holding that "[w]hether a questioned use is a use in another manner seems to us to depend on the type of use envisioned in the creation of the program,"[29] directly conflicts with the Fifth Circuit's *Vault Corp.* holding.

2. The Decision Below Conflicts with this Court's Established Principles of Statutory Construction.

A. The Word "Owner" Has the Same Meaning in Sections 109 and 117.

As discussed above, the Federal Circuit recognized that the indicia of ownership of a copy in Section 117 must be consistent with a copy owner's rights under the Section 109 first sale doctrine.[30] This is in accord with the "normal rule of statutory construction, . . . that identical words used in different parts of the same act are intended to have the same meaning,"[31] It is also "a fundamental canon of statutory construction that the words of a statute must be read

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[28] *Id.*

[29] Pet. App. 22a.

[30] *DSC Communications*, 170 F.3d at 1361.

[31] *Commissioner of Internal Revenue v. Keystone Consolidated Industries*, 508 U.S. 152, 159, 113 S.Ct. 2006, 2011, 124 L.Ed.2d 71 (1993) (internal quotation marks and citation omitted).

in their context and with a view to their place in the overall statutory scheme."[32]

The Second Circuit departed from these rules of construction by redefining "owner" in Section 117 in a manner that is wholly inconsistent with the established meaning of "owner" in Section 109.

(1) An "Owner of a Particular Copy" in Section 109(a) Refers to an Owner with Full and Formal Title in the Copy.

The first sale doctrine—rooted in the English common law rule against restraints on alienation of property[33]—authorizes the owner of a particular lawfully made copy that embodies a copyrighted work to sell or otherwise dispose of the possession of that copy without the copyright owner's consent. [34] As such, the first sale doctrine limits the copyright owner's exclusive right of distribution of a copy to the first sale of that particular copy. 17 U.S.C. § 109.

United States courts applied the first sale doctrine long before its first codification in 1909.[35] For example, in

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[32] *Owasso Independent School District v. Falvo*, 534 U.S. 426, 434, 122 S.Ct. 934, 939-940, 151 L.Ed.2d 896 (2002).

[33] A "restraint on alienation" is a generally unenforceable restriction on a vested owner's ability to sell or transfer property. *See* Black's Law Dictionary (8th ed. 2004) (Westlaw).

[34] Certain exceptions relating to prohibitions against sound recording and computer program renting have been added to Section 109. *See* 17 U.S.C. § 109(b).

[35] The first sale doctrine set forth in 17 U.S.C. § 109 was first codified in the 1909 Copyright Act (Copyright Act of 1909, ch. 320, § 41,

1886, the Southern District of Ohio held that a copy's purchaser receives the right to sell that copy.

> A genuine copy, owned by the owner of the copyright, carries with it the ordinary incidents of alienation belonging alike to all property, and, if he parts with the copyright, he retains with the ownership of the particular copy this power of sale; or if he sells a copy to another, having, as owner of the copyright, authorized a transfer, *the purchaser takes the copy with the ordinary incident of alienation belonging to all property*; and that copy is no longer under the copyright law.[36]

Thereafter, in 1894, The Second Circuit applied the first sale doctrine, holding that a purchaser receives the copy without restrictions on alienation.

> But the right to restrain the sale of a particular copy of the book by virtue of the copyright statutes has gone when the owner of the copyright and of that copy has parted with all his title to it, and *has conferred an absolute title to the copy upon a purchaser*, although with an agreement for a restricted use. The exclusive right to vend the particular copy no longer remains in the owner of the copyright by the copyright statutes. The new purchaser cannot reprint the copy. He cannot print or publish a new edition of the book; but, the copy having been absolutely sold to him, the

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35 Stat. 1084) and retained, as Section 27, as part of the Act's recodification in 1947 (Copyright Act of 1947, ch. 391, § 27, 61 Stat. 660).

[36] *Henry Bill Publishing Co. v. Smythe*, 27 F. 914, 925 (S.D. Ohio, 1886) (emphasis added).

> ordinary incidents of ownership in personal property, among which is the right of alienation, attach to it.[37]

Almost a decade and a half later, in 1908, this Court, affirming the Second Circuit,[38] endorsed the first doctrine.[39]

> The precise question, therefore, in this case is, Does the sole right to vend (named in § 4952) [40] secure to the owner of the copyright the right, after a sale of the book to a purchaser, to restrict future sales of the book at retail, to the right to sell it at a certain price per copy, because of a notice in the book that a sale at a different price will be treated as an infringement, which notice has been brought home to one undertaking to sell for less than the named sum? We do not think the statute can be given such a construction . . .[41]

The following year, Congress codified the first sale doctrine in § 41 of the Copyright Act of 1909. Congress retained the doctrine in § 27 of the 1947 Act.[42] As set forth in those enactments, the statutory first sale doctrine stated that:

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[37] *Harrison v. Maynard, Merrill & Co.*, 61 F. 689, 691 (2d Cir. 1894) (emphasis added).

[38] *Bobbs-Merrill Co. v. Straus*, 147 F. 15 (2d Cir. 1906), *affirmed*, 210 U.S. 339, 28 S.Ct. 722, 52 L.Ed. 1086 (1908).

[39] *Bobbs-Merrill Co.*, 210 U.S. 339, 28 S.Ct. 722, 52 L.Ed. 1086.

[40] Rev.St.U.S. § 4952 (U. S. Comp. Stat. 1901, p. 3406).

[41] *Bobbs-Merrill Co.*, 210 U.S. at 350, 28 S.Ct. at 726 (footnote added).

[42] *See* note 35.

> [N]othing in this Act shall be deemed to forbid, prevent, or restrict the transfer of any copy of a copyrighted work the possession of which has been lawfully obtained.[43]

Congress, in the Copyright Act of 1976, eliminated former § 27's language "possession of which has been lawfully obtained" in favor of the new § 109's "owner of a particular copy." As enacted in 1976, § 109(a) and (c) stated:

> (a) Notwithstanding the provisions of section 106(3), the owner of a particular copy or phonorecord lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord.
>
> (c) The privileges prescribed by subsections (a) and (b) do not, unless authorized by the copyright owner, extend to any person who has acquired possession of the copy or phonorecord from the copyright owner, by rental, lease, loan, or otherwise, without acquiring ownership of it.[44]

Congress, in connection with the 1976 revision, provided an example of the first sale doctrine's applicability.

> [T]he *outright sale* of an authorized copy of a book frees it from any copyright control over its

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[43] *Quality King Distributors, Inc. v. L'Anza Research International, Inc.*, 523 U.S. 135, 142, n9, 118 S.Ct. 1125, 1129, n9, 140 L.Ed.2d 254 (1998).

[44] 17 U.S.C. § 109(a) and (c) as enacted in 1976 (Pub. L. No. 94-553, 90 Stat. 2541. § 101).

resale price or other conditions of its future disposition.[45]

(2) The Second Circuit Overlooked CONTU's Recommendation Concerning the Sale of All Rights in the Copy.

In 1974, Congress created the National Commission on New Technological Uses of Copyrighted Works ("CONTU") as part of the comprehensive revision of the copyright laws that resulted in the Copyright Act of 1976, P.L. 94-553, codified as 17 U.S.C. §101, *et seq.*[46] CONTU was chartered to study and compile data concerning problems occasioned by the use of the new technologies of photocopying and computers on the authorship, distribution and use of copyrighted works, and to report to the President and the Congress with recommendations for amendments to the copyright law "to assure public access to copyrighted works used in conjunction with computer and machine duplication systems and to respect the rights of owners of copyright in such works, while considering the concerns of the general public and the consumer."[47]

CONTU was well aware of the first sale doctrine. Indeed, CONTU equated Section 109(a)'s limitation on a copyright owner's exclusive distribution rights to an

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[45] H.R. Rep. No. 1476, 94th Cong., 2nd Sess. (1976), page 79 (emphasis added).

[46] P.L. 93-573, Title II, §§ 201-208 (1974), amended by P.L. 95-146 (1977).

[47] Final Report of the National Commission on New Technological Uses of Copyrighted Works, July 31, 1978 (the "CONTU Report"), page 1 (Library of Congress, Washington, D.C. 1979). Excerpts of the CONTU Report are set forth at Pet. App. 68a-81a.

owner of a particular copy to its proposed Section 117(a)'s limitation on a copyright owner's exclusive reproduction rights to a rightful possessor of a copy. In this regard, CONTU intended "rightful possessor of a copy" to refer to an owner of all title in the copy. Thus, citing § 109(a) in connection with its Section 117 recommendations, CONTU explained:

> The sale of a copy of a program by a rightful possessor to another must be of all rights in the program, thus creating a new rightful possessor and destroying that status as regards the seller. This is in accord with the intent of that portion of the law which provides that owners of authorized copies of a copyrighted work may sell those copies without leave of the copyright proprietor.[48]

(3) Congress Conformed CONTU's Proposed Language to the Copyright Act's Preexisting Language.

When adopting CONTU's recommendations, Congress, in Section 117(a), revised CONTU's "rightful possessor of a copy" language to "owner of a copy" to conform Section 117(a)'s statutory language with the existing Section 109(a)'s language. The amended language also conformed to the 1976 Copyright Act's revision of the first sale doctrine's terminology—from superceded Section 27's "the possession of which has been lawfully obtained" to Section 109(a)'s "the owner of a particular copy."

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[48] CONTU Report at 13 (footnote citing 17 U.S.C. § 109(a) omitted) reproduced at Pet. App. 78a-79a.

(4) The Second Circuit Should Have Read "Owner" Consistently in §§ 109(a) and 117(a).

As demonstrated above, both Congress and CONTU intended to limit the Section 117(a) affirmative defense to those possessing formal title. In revising CONTU's recommended "rightful possessor of a copy" language to "owner of a copy," Congress demonstrated its intention to give the word "owner" in Section 117(a) the same meaning as the word "owner" in Section 109(a). That is, an owner with full title in the copy.

The Second Circuit had no statutory basis to depart from the Copyright Act's well established meaning of "owner" as used in Section 109.

B. The Second Circuit Artificially Replaced Section 117(a)'s Word "Essential" with the Word "Necessary."

The plain language of Section 117(a)(1)—"that such a new copy or adaptation is created as an essential step in the utilization of the computer program in conjunction with a machine and that it is used in no other manner"—announces the statute's meaning. Only a copy or adaption that is essential to a computer's mechanical operation can qualify for the Section 117(a)(1) defense. Assuming an ambiguity, it is quickly put to rest by the CONTU Report's explanation of the statute's 1980 amendment.

> Because the placement of a work into a computer is the preparation of a copy, the law should provide that persons in rightful possession of copies of programs be able to use them freely without fear of exposure to copyright liability.

* * *

> Because of a lack of complete standardization among programming languages and hardware in the computer industry, one who rightfully acquires a copy of a program frequently cannot use it without adapting it to that limited extent which will allow its use in the possessor's computer.[49]

Further, Section 117's meaning was reaffirmed in the 1998 Computer Maintenance Competition Assurance Act and its legislative history.[50]

In order to reach its erroneous holding, the Second Circuit engaged in linguistic contortions. Rather than look to the meaning of the word "essential," the Second Circuit substituted the word "necessary" that, unlike "essential," is susceptible of various meanings.

As the Second Circuit put it:

> 'Essential' is often used as a synonym of 'necessary,' as indicated by its dictionary definition. Particularly as used in the law, the word 'necessary' is ambiguous. According to Black's Law Dictionary, the word is 'susceptible of various meanings. It may import absolute physical necessity or inevitability, or it may import that which is only convenient, useful, appropriate, suitable, proper, or conducive to the end sought.' Black's Law Dictionary 928 (5th ed.1979); Black's Law Dictionary 1181 (rev. 4th ed.1968).[5] *See also*

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[49] CONTU Report at 13, reproduced at Pet. App. 78a-79a.

[50] The Computer Maintenance Competition Assurance Act, Pub. L. No. 105-304, 112 Stat. 2860, 2887; Senate Rep. No. 105-190 (May 11, 1998), pp. 21-22.

> *M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 388, 4 L.Ed. 579 (1819) ('The word necessary, standing by itself, has no inflexible meaning; it is used in a sense more or less strict, according to the subject.'). The same ambiguity inheres in the word 'essential,' which in some of its meanings is effectively synonymous with 'necessary.' We reject Krause's contention that the word 'essential' can apply only to a modification without which the program could not function.
>
> [Footnote 5]: The sixth edition of Black's contains the same definition, but Black's thereafter stopped defining the word 'necessary.' Compare Black's Law Dictionary 1058 (8th ed.2004), and Black's Law Dictionary 1052 (7th ed.1999), with Black's Law Dictionary 1029 (6th ed.1990).[51]

As shown in footnote 5 (quoted above) of the Second Circuit's decision, the court searched through the Sixth, Seventh, and Eighth editions of Black's Law Dictionary before it found a definition of "necessary," in the Fourth and Fifth editions, to support its view of Section 117(a)'s ambiguity. The Second Circuit did not, however, explain its decision to use Black's Law Dictionary definitions of "necessary" when definitions of "essential" were readily

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[51] Pet. App. 16a. Curiously, the Second Circuit's citation to *M'Culloch* v. *Maryland*, 17 U.S. (4 Wheat.) 316 ,388, 4 L.Ed. 579 (1819) for the quotation "The word necessary, standing by itself, has no inflexible meaning; it is used in a sense more or less strict, according to the subject," does not signal that the quotation is set forth in the summary of the plaintiff in error's reply argument, not in this Court's opinion (Marshall, Ch. J.) that commences at 17 U.S. (4 Wheat.) 400.

available in those volumes.[52] An examination of "essential's" definition from the same Black's Law Dictionary editions, reproduced at Pet. App. 82a, demonstrates the lack of ambiguity in the language that Congress adopted.

Indeed, the Black's Law Dictionary definition of "essential"—"Indispensably necessary; important in the highest degree; requisite"—does not support the Second Circuit's view that "The same ambiguity inheres in the word 'essential,' which in some of its meanings is effectively synonymous with 'necessary.'"[53] While Black's Law Dictionary reports that "necessary" "is a word susceptible of various meanings," it provides no such meaning for "essential."[54]

3. The Decision Below Established a Rule That Authorizes Software Licensees—Based on Their Subjective Opinions of a Program's Purpose—to Prepare Computer Program Derivative Works Without the Copyright Owner's Consent.

As a result of the Second Circuit's decision below, computer program licensees are free to modify copyrighted programs for any purpose they claim as their reason for acquiring the software. As the Second Circuit authorized the Respondents, licensees may now reverse engineer executable program files to obtain source code and prepare derivative works that would otherwise infringe copyright owners' exclusive rights under 17 U.S.C. § 106(2). Leaving the Second Circuit's decision intact destroys the balance that Congress struck in adopt-

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[52] Pet. App. 82a-84a.

[53] Pet. App. 16a, 82a.

[54] Pet. App. 82a-84a.

ing the CONTU Report's recommendation between copyright owners' exclusive right to prepare derivative works and software users' need—when there was "a lack of complete standardization among programming languages and hardware in the computer industry"—to adapt a program "to that limited extent which will allow its use in the possessor's computer."[55]

CONCLUSION

The petition for a writ of certiorari should be granted.

August 1, 2005

Respectfully submitted,

S/

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[55] CONTU Report at 13, reproduced at Pet. App. 78a-79a.

APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

August Term, 2004

(Argued: September 30, 2004

Decided: March 21, 2005

Errata Filed: March 23, 2005)

Docket No. 03-9303

WILLIAM KRAUSE dba Special-T software,

Plaintiff-Appellant,

v.

TITLESERV, INC., NEW YORK SETTLEMENT CORP., DAVID EISENBERG, KENNETH WODISKA, THOMAS MURPHY and JAMES J. CONWAY, III,

Defendant-Appellees.

Before:

LEVAL AND KATZMANN,

*Circuit Judges.**

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* The Honorable Ellsworth Van Graafeiland, who was a member of the panel, died following argument, and the appeal is being decided by the remaining two members of the panel, who are in agreement. *See* 2d Cir. R. 0.14(b).

Appeal from the judgment of the United States District Court for the Eastern District of New York (Platt, *J.)* granting defendant-appellees' motion for summary judgment in copyright infringement suit. The Court of Appeals (Leval, *J.)* holds that 17 U.S.C. § 117(a) authorized defendant-appellees to adapt their copies of software programs because, within the meaning of § 117(a), they (i) owned the copies; (ii) created the adaptations as an "an essential step in the utilization of the computer program in conjunction with a machine"; and (iii) used the adaptations "in no other manner." AFFIRMED.

EUGENE D. BERMAN, Fine, Fine & Berman, LLP (Scott J. Fine, on the brief), Melville, NY, for *Plaintiff-Appellant.*

RONALD J. ROSENBERG, Rosenberg Calica & Birney LLP (Kenneth E. Aneser, on the brief), Garden City, NY, for *Defendant-Appellees.*

LEVAL, *Circuit Judge*:

Plaintiff William Krause appeals from a judgment of the United States District Court for the Eastern District of New York (Thomas C. Platt, *J.)* granting defendants' motion for summary judgment. Krause brought this suit against Titleserv, its owner and CEO, three employees, and an affiliated company (collectively "Titleserv"). The complaint alleged that Titleserv infringed the plaintiff's copyright by modifying the source code of eight computer programs he authored for Titleserv.

Titleserv moved for summary judgment on the basis of 17 U.S.C. § 117(a)(1) (as well as on other grounds). Section 117(a)(1) provides an affirmative defense against copyright infringement for anyone who (i) owns a physical copy of a computer program, (ii) makes an adaptation "as an essential step in the utilization of the computer program in conjunction with a machine," and (iii) uses it "in no other manner." The district court, following the recommendation of Magistrate Judge William D. Wall, concluded there was no genuine issue of material fact and granted summary judgment in favor of Titleserv.

On appeal, Krause challenges the district court's interpretation and application of § 117(a)(1). We affirm.

BACKGROUND

Between 1986 and 1996 plaintiff Krause performed computer and communications work for Titleserv. He wrote over thirty-five computer programs for Titleserv. The eight programs at issue in this suit were designed to enable Titleserv to track and report on the status of client requests and other aspects of its operations. The programs were installed on Titleserv's computer network and were thus accessible to Titleserv employees.

Krause wrote the programs in Clipper, a DOS-based programming language. Code written in such a programming language is called source code. Source code becomes executable only when it is run through a compiler which converts it into the binary 1s and 0s of object, or executable, code. *See Universal City Studios, Inc. v. Corley*, 273 F.3d 429, 438-39 (2d Cir. 2001).

In 1996, Krause and Titleserv began negotiating Krause's assignment of the copyright in his programs to Titleserv in exchange for a five-year consulting agreement. On July 10,

1996, before any agreement was reached, Krause terminated his relationship with Titleserv after learning that Titleserv intended that he take direction from its new Director of Information Technology. When Krause left, he took his notebook computer, which contained the only copies of the source code for two of the programs. He left copies of the source code for the other six disputed programs on the Titleserv file servers because Titleserv had backup tapes, so that in Krause's words, "removing the source from the file servers would have been a meaningless gesture." Krause left executable versions of all eight programs at issue on Titleserv's file servers, but locked them with a command, which prevented a popular decompiler from converting the executable code back into source code.

Krause told Titleserv that it was free to continue using the executable code as it existed on the day Krause left, but asserted that Titleserv had no right to modify the source code. Inability to modify the source code would have severely limited the value of those programs to Titleserv. Many routine functions such as the addition of a new customer or a change of a customer address could be performed only by changing the source code. In addition, changes were required to fix bugs from time to time to keep the system from crashing.

On July 16, 1996, Titleserv filed suit against Krause in state court alleging, *inter alia,* misappropriation of its property.[1] Employees of Titleserv subsequently circumvented the "lock" he had placed on the executable code and decompiled it back into source code. An employee then set about "cleaning up" the source code by formatting

[1] The state suit was still pending at the time the district court granted summary judgment in the present action. Nothing in the record indicates that the state suit has concluded.

it, assigning proper variable names, and adding comments. Titleserv made further modifications, including the fixing of bugs, the addition of new customers, and changes in customer addresses, to keep the old programs functional while Titleserv developed a new, Windows-based system. Krause's system was then phased out at some point between late 1997 and early 1998.

Krause brought this suit in the Eastern District of New York. The complaint, as amended, states a single cause of action for copyright infringement based on Titleserv's alleged copying of his programs and its production of derivative works.

After discovery, Titleserv moved for summary judgment. The district court referred the matter to Magistrate Judge Wall, who recommended granting summary judgment in favor of Titleserv on the ground that Titleserv's use and modification of Krause's programs was protected by 17 U.S.C. § 117(a)(1).

On October 30, 2003, the district court adopted the magistrate judge's report and granted summary judgment for Titleserv. *Krause v. Titleserv, Inc.*, 289 F. Supp. 2d 316 (E.D.N.Y. 2003). Krause then brought this appeal.

DISCUSSION

This appeal turns on whether Titleserv was entitled to summary judgment on the basis of the affirmative defense provided in 17 U.S.C. § 117(a)(1), as the district court found.[2] Section 117(a) allows the owner of a copy of a

[2] Titleserv initially asserted that the programs were "works made for hire" within the meaning of 17 U.S.C. § 201(b). It later asserted entitlement to summary judgment regardless of whether Krause was an independent contractor or employee. For the purposes of its summary judgment ruling, the district court, adopting the magistrate judge's

computer program to copy or modify the program for limited purposes without incurring liability for infringement. It states:

> Notwithstanding the provisions of section 106 [which generally provides, *inter alia*, that copying of a protected work is an infringement], it is not an infringement for the owner of a copy of a computer program to make or authorize the making of another copy or adaptation of that computer program provided:
>
> (1) that such a new copy or adaptation is created as an essential step in the utilization of the computer program in conjunction with a machine and that it is used in no other manner, or
>
> (2) that such new copy or adaptation is for archival purposes only and that all archival copies are destroyed in the event that continued possession of the computer program should cease to be rightful.

We are concerned only with subparagraph (1), as Titleserv has not alleged that it copied Krause's programs solely for archival purposes.

To come within the protection of § 117(a)(1) on these facts, Titleserv must demonstrate that the new adaptation of Krause's program (i) was made by the "owner of a copy of [the] computer program"; (ii) was "created as an essential step in the utilization of the computer program in conjunction with a machine"; and (iii) was "used in no other manner."

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report, assumed *arguendo* that Krause was an independent contractor and owner of the copyright in the programs he developed.

I. "[O]wner of a copy of a computer program"

Because § 117(a) protects only "the owner of a copy of a computer program," we must first determine whether Titleserv owned the copies of the computer programs at issue. Ownership of a copy is something distinct from copyright ownership. *See* 17 U.S.C. § 202 ("Ownership of a copyright, or of any of the exclusive rights under a copyright, is distinct from ownership of any material object in which the work is embodied."). For example, the author of a book, or her assignee, ordinarily owns the copyright in the book and thus the sole right to authorize copying; each purchaser of a copy of the book owns that copy, but is generally not entitled to make copies from it.

It is undisputed that Titleserv *possessed* executable copies of all the programs. The parties disagree whether Titleserv *owned* those copies within the meaning of § 117(a). Krause claims that Titleserv never owned the program copies saved on its file server, but rather possessed the copies as a licensee pursuant to an oral agreement. Titleserv asserts that it owns copies of the programs because it paid Krause a substantial sum to develop them and has an undisputed right to possess and use them permanently.

Interpreting the word "owner" is more complex than might first appear. Ownership of property is often described as a bundle of rights. *See, e.g., Flagg Bros., Inc. v. Brooks,* 436 U.S. 149, 160 n.10 (1978) (observing that for purposes of interpreting the Fourteenth Amendment, a "property interest is not a monolithic, abstract concept hovering in the legal stratosphere. It is a bundle of rights . . . ."). It is not clear from the text of § 117(a) how many and what kind of sticks may be removed from the bundle before the possessor of a copy of a computer program is no longer considered its owner for purposes of § 117(a).

The legislative history of § 117(a) is sparse and provides limited guidance on this point. Section 117(a) was based on the recommendations of the National Commission on New Technological Uses of Copyrighted Works ("CONTU" or the "Commission"). Congress largely enacted the language proposed by the Commission, with one notable exception. The report originally proposed making the affirmative defense of § 117(a) available to the *"rightful possessor* of a copy of a computer program." *Final Report of the National Commission on New Technological Uses of Copyrighted Works* 12 (1978) (emphasis added) [hereinafter *"CONTU Report"].* Congress changed the term "rightful possessor" to "owner" but did not explain its reason. *See* H.R. Rep. No. 96-1307(I), at 23 (1980), *reprinted in* 1980 U.S.C.C.A.N. 6460, 6482.

Krause contends that Congress's substitution of the word "owner" for the Commission's term, which would have accorded adaptation rights to any "rightful possessor," reveals that Congress intended to restrict the benefit of the statute to title owners. At least one district court has agreed. *See Applied Info. Mgmt. v. Icart,* 976 F. Supp. 149, 153 (E.D.N.Y. 1997). Other courts have attached less importance to formal title, looking rather at the various incidents of ownership. The Federal Circuit followed this latter approach in *DSC Communications Corp. v. Pulse Communications, Inc.,* 170 F.3d 1354 (Fed. Cir. 1999). *DSC Communications* involved a contributory infringement claim that required the court to determine whether the Regional Bell Operating Companies ("RBOCs") owned copies of the software they transferred regularly onto interface cards. The Federal Circuit concluded that the RBOCs were not owners within the meaning of § 117(a), not merely because the RBOCs did not have title, but rather because

licensing agreements with the copyright holder "severely limit[ed] the rights of the RBOCs with respect to the . . . software in ways that are inconsistent with the rights normally enjoyed by owners of copies of software." *Id.* at 1361. For example, the agreements prohibited the RBOCs from using DSC's software on hardware other than that provided by DSC. *Id.* The agreements also limited the authority of the RBOCs to transfer copies of the software, even though the "first sale" doctrine would have protected certain transfers if the RBOCs had owned copies of the software. *Id.*

In our view, Congress's decision to reject "rightful possessor" in favor of "owner" does not indicate an intention to limit the protection of the statute to those possessing formal title. The term "rightful possessor" is quite broad. Had that term been used, the authority granted by the statute would benefit a messenger delivering a program, a bailee, or countless others temporarily in lawful possession of a copy. Congress easily could have intended to reject so broad a category of beneficiaries without intending a narrow, formalistic definition of ownership dependent on title.

Several considerations militate against interpreting § 117(a) to require formal title in a program copy. First, whether a party possesses formal title will frequently be a matter of state law. *See* 2 Melville B. Nimmer & David Nimmer, *Nimmer on Copyright* § 8.08[B][1] (stating that copy ownership "arises presumably under state law"). The result would be to undermine some of the uniformity achieved by the Copyright Act. The same transaction might be deemed a sale under one state's law and a lease under another's. If § 117(a) required formal title, two software users, engaged in substantively identical transactions might find that one

is liable for copyright infringement while the other is protected by § 117(a), depending solely on the state in which the conduct occurred. Such a result would contradict the Copyright Act's "express objective of creating national, uniform copyright law by broadly preempting state statutory and common-law copyright regulation." *Cmty. for Creative Non-Violence v. Reid,* 490 U.S. 730, 740 (1989); *see also* 17 U.S.C. § 301(a).

Second, it seems anomalous for a user whose degree of ownership of a copy is so complete that he may lawfully use it and keep it forever, or if so disposed, throw it in the trash, to be nonetheless unauthorized to fix it when it develops a bug, or to make an archival copy as backup security.

We conclude for these reasons that formal title in a program copy is not an absolute prerequisite to qualifying for § 117(a)'s affirmative defense. Instead, courts should inquire into whether the party exercises sufficient incidents of ownership over a copy of the program to be sensibly considered the owner of the copy for purposes of § 117(a). The presence or absence of formal title may of course be a factor in this inquiry, but the absence of formal title may be outweighed by evidence that the possessor of the copy enjoys sufficiently broad rights over it to be sensibly considered its owner.

We conclude that Titleserv owned copies of the disputed programs within the meaning of § 117(a). We reach this conclusion in consideration of the following factors: Titleserv paid Krause substantial consideration to develop the programs for its sole benefit. Krause customized the software to serve Titleserv's operations. The copies were stored on a server owned by Titleserv. Krause never reserved the right to repossess the copies used by Titleserv

and agreed that Titleserv had the right to continue to possess and use the programs forever, regardless whether its relationship with Krause terminated. Titleserv was similarly free to discard or destroy the copies any time it wished. In our view, the pertinent facts in the aggregate satisfy § 117(a)'s requirement of ownership of a copy.

Krause responds to this strong evidence of ownership by asserting that Titleserv, acting through its CEO, orally agreed to possess the copies as a mere licensee. He claims evidentiary support in six of his own prior statements. His reliance on these statements, however, confuses ownership of a copyright with ownership of a copy of the copyrighted material. Most of the cited passages, when read in context, relate to the ownership and/or right to use of the copyright, and not to ownership of the copies.[3] Krause's ownership of

[3] For example, the first and second citations are to affidavits executed by Krause in which he says that Titleserv's CEO "agreed that any programs which I developed would belong to me." The rest of the paragraph indicates that Krause and Titleserv's CEO were discussing copyright ownership, not ownership of copies of the programs. The third citation is to Krause's complaint in a counter-suit he filed in state court, which alleges that "defendants paid a license fee to plaintiff for the programs developed by him." The complaint also states, "Throughout the time of the relationship, until recently, [Titleserv's CEO] acknowledged plaintiff's ownership of the various computer programs which he developed for defendants." Again, these statements are about copyright ownership. In the fourth citation (to Krause's deposition), it also does not appear that Krause is discussing ownership of program copies, as opposed to the terms of the copyright license. As for the fifth citation, to the extent that it includes Krause's assertion that he "gave [Titleserv] permission to use copies of the programs," perhaps implying Krause's ownership of the copies, Krause's perception that he remained the owner of the copies would not alter our conclusion. This is because, as explained above, our conclusion that Titleserv satisfied § 117(a)'s requirement of "owner[ship]" depends on its possession of sufficient functional incidents of ownership, regardless of title.

the copyright in the programs is not disputed, but is irrelevant to Titleserv's rights under § 117(a), which depend on ownership of a copy of the copyrighted material. The final citation is to Krause's deposition in which he gave the conclusory answer "No" when asked "When you left on July 10, 1996, did Titleserv own the copies of the executables?" This conclusory assertion on an issue of law is not sufficient to raise a material issue of fact. *See Jorgensen v. Epic/Sony Records,* 351 F.3d 46, 51, 56 & n.9 (2d Cir. 2003).

We conclude in the absence of other evidence that Titleserv's right, for which it paid substantial sums, to possess and use a copy indefinitely without material restriction, as well as to discard or destroy it at will, gave it sufficient incidents of ownership to make it the owner of the copy for purposes of applying § 117(a).[4]

II. "[C]reated as an essential step in the utilization of the computer program in conjunction with a machine"

The next statutory factor Titleserv must satisfy addresses whether Titleserv's modification of the programs was "an essential step in the utilization of the computer program[s] in conjunction with a machine." The district court and the magistrate judge both relied heavily on our decision in *Aymes v. Bonelli,* 47 F.3d 23 (2d Cir. 1995) *(Aymes II)* in finding that Titleserv's modifications qualified. *Aymes II* involved programs designed to assist the inventory, record-keeping, and sales functions of a chain of retail stores sell-

[4] With respect to Krause's claim to have told Titleserv it had no right to modify the programs once he left, Titleserv's entitlement to do what it did arose as a matter of law and Krause's expression of his opinion that it had no entitlement to do these things has no significance whatsoever.

ing swimming pools and pool supplies. *Id.* at 24. The defendants, which were the users of the programs, modified the programs to keep them up-to-date and to ensure their compatibility with the defendants' successive generations of computer systems. *Id.* at 26. The plaintiff, who owned the copyright in the programs, alleged that the defendants' unauthorized modifications infringed his copyright. We concluded that the modifications were essential to the defendants' utilization of the programs within the meaning of § 117(a)(1) because the "adaptations were essential to allow use of the program[s] for the very purpose for which [they were] purchased." *Id.* at 27.

The modifications allegedly made by Titleserv to its copy of the programs fall into four main categories: (1) correcting programming errors or "bugs," which interfered with the proper functioning of the programs; (2) changing the source code to add new clients, insert changed client addresses, and perform other routine tasks necessary to keep the programs up-to-date and to maintain their usefulness to Titleserv; (3) incorporating the programs into the Windows-based system Titleserv designed and implemented between 1997 and 1998; and (4) adding capabilities, such as the ability to print checks, and, to a limited degree, allowing customers direct access to their records, which made Titleserv's copy of the programs more responsive to the needs of Titleserv's business.

As for the first two types of modifications, a straightforward application of *Aymes II* to the undisputed facts establishes that these modifications constituted "essential step[s] in the utilization of the computer program[s] in conjunction with a machine." The fixing of bugs was done so that the programs would continue to function. Without

such fixing, the programs would not function properly. It cannot seriously be disputed that such fixing is "essential." Titleserv's modification of the source code to reflect such business changes as the addition of new customers and changed customer addresses also comes within the scope of the modifications approved in *Aymes II,* which were designed to keep the software in step with changes in the defendants' business.

As for the third type of modifications, involving adaptation of the programs so that they would function on Titleserv's new Windows-based system, we note in passing that Titleserv vigorously denies Krause's allegation that it copied his programs into the new system. In adjudicating Titleserv's motion for summary judgment, however, we must utilize the version of the evidence most favorable to Krause, drawing all permissible inferences in his favor. *Cifarelli v. Vill. of Babylon,* 93 F.3d 47, 51 (2d Cir. 1996). Utilizing that standard to assume that Titleserv did incorporate copyrighted matter from Krause's programs into its new system, we nonetheless conclude, following *Aymes II,* that such adaptation qualifies under § 117(a)(1) as an "essential step." In *Aymes II,* we reached the same conclusion as to the defendants' adaptation of their copy of the software so that it would continue to function on the defendants' new computer system. 47 F.3d at 26-27.

The only category of Titleserv's modifications requiring additional analysis is the fourth category: the addition of new features, such as check printing and providing for direct client access. Such changes were not strictly necessary to keep the programs functioning, but were designed to improve their functionality in serving the business for which they were created.

Focusing on § 117(a)(1)'s use of the word "essential," Krause argues that an adaptation or change does not come within the protection of § 117(a)(1) unless it is truly necessary to the functioning of the system. He thus argues that, while the fixing of bugs may be permitted because such repairs are "essential" to keep the program operating, adaptations that improve the functionality of the system but are not required to keep it operational cannot qualify.

We already implicitly rejected Krause's argument in *Aymes II*. In that case, some of the program changes approved by our ruling as falling within the protection of § 117(a)(1) had nothing to do with enabling the programs to continue functioning; they rather involved adapting the programs to changes in the defendants' business. For example, the *Aymes II* defendants changed product lines, from gas barbecues to ceiling fans to swimming pool supplies, and the alterations of the programs were designed to maintain the utility of the programs in connection with these changes in product lines. Joint App. at I2-3, *Aymes II*, 47 F.3d 23. Unless we were to retreat from that ruling, we would be compelled to reject the narrow reading of § 117(a)(1) which Krause urges on us.

We see no reason to retreat from *Aymes II*. The statute is ambiguous on the point in question. The word "essential" is defined as "necessary, indispensable," or "unavoidable." *See Webster's Third New International Dictionary* 777 (1976). In use, its meaning varies considerably from one context to another. For example, one might say it is "essential" when driving a car to stay alert. This does not mean it is impossible to drive a car without being alert, but rather stresses the importance of staying alert. Similarly, one might ask an "essential" question. This does not mean the question had to be asked, but rather that it goes to the heart of the matter.

"Essential" is often used as a synonym of "necessary," as indicated by its dictionary definition. Particularly as used in the law, the word "necessary" is ambiguous. According to *Black's Law Dictionary,* the word is "susceptible of various meanings. It may import absolute physical necessity or inevitabilty, or it may import that which is only convenient, useful, appropriate, suitable, proper, or conducive to the end sought." *Black's Law Dictionary* 928 (5th ed. 1979); *Black's Law Dictionary* 1181 (rev. 4th ed. 1968).[5] *See also M'Culloch v. Maryland,* 17 U.S. (Wheat.) 316, 388 (1819) ("The word *necessary,* standing by itself, has no inflexible meaning; it is used in a sense more or less strict, according to the subject."). The same ambiguity inheres in the word "essential," which in some of its meanings is effectively synonymous with "necessary." We reject Krause's contention that the word "essential" can apply only to a modification without which the program could not function.

Moreover, Krause focuses too narrowly on the word "essential." The meaning of the phrase "an essential step in the utilization of the computer program" is equally dependent on the word "utilization." The dictionary defines "utilize" as "to make useful," "turn to profitable account or use," "make use of," and "convert to use." *Webster's Third New International Dictionary* at 2525. This definition sheds little light on what the word "utilization" means in the context of § 117(a)(1). "Utilization" of a computer program might refer exclusively to booting and running the

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[5] The sixth edition of *Black's* contains the same definition, but *Black's* thereafter stopped defining the word "necessary." *Compare Black's Law Dictionary* 1058 (8th ed. 2004), *and Black's Law Dictionary* 1052 (7th ed. 1999), *with Black's Law Dictionary* 1029 (6th ed. 1990).

program, in which case only limited modification, such as fixing bugs to prevent the program from crashing, might qualify as an "essential step" in booting or running the program. On the other hand, "utilization" might refer more broadly to "mak[ing] [the program] useful" to the owner of the copy, in which case more extensive modification that involved adding new program features to enhance functionality might qualify as an "essential step" in making the program useful. Accordingly, even if the word "essential" is given a narrow meaning, encompassing only absolute necessity, § 117(a)(1) remains ambiguous because the statute does not clearly indicate *for what end* modifications must be absolutely necessary.

In arguing that § 117(a)(1) authorizes only adaptations absolutely necessary to make a program boot or run, Krause contends that his interpretation is required to avoid rendering the phrase "in conjunction with a machine" superfluous. His argument goes as follows: Because a computer program inevitably functions on a machine, the statutory words "in conjunction with a machine" would be tautological and unnecessary if given their ordinary meaning. On the assumption that Congress intends every portion of a statute to have meaning, the phrase "in conjunction with a machine" must therefore place an additional limitation on the scope of § 117(a)(1). That limitation restricts the meaning of "essential step" to those modifications absolutely necessary to make a program boot and run.

Krause is mistaken in suggesting that the words "in conjunction with a machine" are tautological if given their plain meaning. Those words can serve to broaden § 117(a)(1) by making clear that the utilization of a program does not need to be in conjunction with what we conventionally call a computer, but can be in conjunction with a

range of machines driven in part by computer programs, such as automobiles, airplanes, and air conditioners. Furthermore, even if the statute used the phrase "in conjunction with a computer," we would see no reason to ascribe specialized meaning to the phrase simply for the sake of avoiding slight repetition in the statutory text. Some repetition can help clarify the meaning of a statute, and we are reluctant to endorse an awkward reading of its words for no better reason than to satisfy the canon of construction that cautions against "adopt[ing] a construction making another statutory provision superfluous." *Hohn v. United States,* 524 U.S. 236, 249 (1998). As we have noted previously, "[g]eneral principles of statutory construction are notoriously unreliable" and "should not take precedence over more convincing reasons." *Hakala v. Deutsche Bank AG,* 343 F.3d 111, 116 (2d Cir. 2003). The Supreme Court has recognized in particular that the "preference for avoiding surplusage constructions is not absolute." *Lamie v. United States Tr.,* 540 U.S. 526, 536 (2004). We therefore reject Krause's argument and conclude that the phrase "in conjunction with a machine" does not cure the ambiguity of the statutory text.

Given the ambiguity of the text, we turn to the legislative history of § 117(a) for guidance. As discussed above, Congress enacted the language proposed in the CONTU Report largely without alteration. The House Report simply states that § 117(a) "embodies the recommendation" of CONTU. H.R. Rep. No. 96-1307(I), at 23 (1980), *reprinted in* 1980 U.S.C.C.A.N. 6460, 6482. We therefore look to the CONTU Report for indications of Congressional intent. *See Aymes II,* 47 F.3d at 26-27; *see also Vault Corp. v. Quaid Software Ltd.,* 847 F.2d 255, 260-61 (5th

Cir. 1988); *Foresight Res. Corp. v. Pfortmiller,* 719 F. Supp. 1006, 1009 (D. Kan. 1989).

Krause asserts that the CONTU Report supports his interpretation of § 117(a)(1). He contends the Commission was primarily concerned with compatibility as between program and computer, which was of particular concern at the time the Report was issued in 1978, during the early stages of personal computer development. His argument relies heavily on one sentence in the report, which says: "Because of a lack of complete standardization among programming languages and hardware in the computer industry, one who rightfully acquires a copy of a program frequently cannot use it without adapting it to that limited extent which will allow its use in the possessor's computer." *CONTU Report* at 13.

Other passages of the report, however, describe the right to modify programs in a manner that goes far beyond concern with compatibility and strongly suggests that the writers of the CONTU Report envisioned a loose concept of necessity that would encompass our very issue—the addition of features so that a program better serves the needs of the customer for which it was created. The report states:

> Thus, a right to make those changes necessary to enable the use for which it was both sold and purchased should be provided. The conversion of a program from one higher-level language to another to facilitate use would fall within this right, *as would the right to add features to the program that were not present at the time of rightful acquisition.*

Id. (emphasis added). Without question, the CONTU Report, in the italicized text, specifically contemplates protection

for modifications adding features, rather than merely securing continued functioning of what was originally created. The CONTU Report thus persuasively rebuts Krause's narrow reading of § 117(a)(1), which would authorize only changes needed to permit the program to function.

The question remains whether the changes Titleserv made to its copies of Krause's programs come within § 117(a)(1)'s broader concept of an "essential step in the utilization of the computer program in conjunction with a machine." We can see no reason why the modest alterations to Titleserv's copies of the programs should not qualify. We need not address whether other types of improvements might be too radical, or might fail to qualify because they somehow harm the interests of the copyright owner. The sentence of the CONTU Report after the one speaking of the right to add features states that the rights granted by § 117(a) could "only be exercised so long as they did not harm the interests of the copyright proprietor." CONTU Report at 13. A different scenario would be presented if Titleserv's alteration somehow interfered with Krause's access to, or ability to exploit, the copyrighted work that he authored, or if the altered copy of Krause's work were to be marketed by the owner of the copy. But on our facts, we see no harm whatsoever to Krause's enjoyment of his copyright. The changes made by Titleserv were made only to its copies of Krause's programs. Krause enjoyed no less opportunity after Titleserv's changes, than before, to use, market, or otherwise reap the fruits of the copyrighted programs he created.

Taking into account the ambiguity of the concepts of "essential" and "utilization," and construing § 117(a) in light of the *CONTU Report* which Congress followed, we conclude that Titleserv's changes to its copy of Krause's

programs were "essential step[s] in the utilization of the computer program[s] in conjunction with a machine" within the meaning of § 117(a)(1).

III. "[U]sed in no other manner"

Finally, § 117(a)(1) requires that the adaptation created as an essential step in the utilization of a computer program in conjunction with a machine be "used in no other manner." Krause contends Titleserv cannot satisfy this requirement because it (1) shared copies of the programs with its subsidiaries, and (2) granted two client banks dial-up access to the programs for a period of approximately one year. He points to a passage from *Aymes II* in which we wrote:

> Finally, there is no merit to Aymes's suggestion that defendants infringed his copyright because they used the programs in an unauthorized manner and for an external purpose. The district court found that [the parent company] used [the programs] for internal business purposes only and did not distribute the program[s] to its subsidiaries.

Aymes II, 47 F.3d at 27 (internal citations omitted). Krause contends this passage conveys by negative implication that § 117(a)(1) does not allow the owner of an adapted copy of a program to share that adaptation with its subsidiaries, much less others. Krause reads too much into this dictum. At most it meant that since there had been no sharing with a subsidiary, the court did not need to consider the argument here advanced that such sharing would defeat the claim.

Whether a questioned use is a use *in another manner* seems to us to depend on the type of use envisioned in the creation of the program. The programs Krause designed for Titleserv were intended to run on Titleserv's file server, where they would be accessible to Titleserv's subsidiaries. These programs were, in other words, designed for use by Titleserv and its subsidiaries. The fact that such use by Titleserv and its subsidiaries continued after Krause's departure does not make such use a use *in another manner.* The use by the subsidiaries was merely a continuation of the kind of use for which the programs were intended.

Although Krause's argument is slightly stronger with respect to his allegation that Titleserv also made the programs available to two client banks through a dial-up connection, we find this argument insufficient as well. In support, Krause points to a passage in a National Science Foundation report submitted to CONTU, which states: "The right to internal use should not include the right to make the work available to outsiders via a computer network or otherwise." *See Apple Computer, Inc. v. Formula Int'l, Inc.*, 594 F. Supp. 617, 621 (C.D. Cal. 1984) (quoting R. Saltman, *Computer Science and Technology: Copyright in Computer-Readable Works: Policy Impacts of Technological Change,* NBS Special Publication 500-17 (Oct. 1977), *reprinted in* III *Copyright, Congress and Technology: The Public Record* 368 (N. Henry ed., 1980)) (emphasis removed).

We think, however, that Krause's argument misses the mark. First, the sentence he quotes appeared in a document submitted to CONTU, not in the CONTU Report. Second, whether a questioned use of an adaptation violates the requirement of "use in no other manner" depends on the facts of the particular case. The programs Krause designed

for Titleserv were designed for the processing of transactions relating to Titleserv's relationship with its customers. For purposes of the "in no other manner" requirement, it seems to us to make little difference whether the programs are accessed and operated by Titleserv's personnel or the personnel of the customer in carrying out or checking on its transactions with Titleserv. What is important is that the transaction for which the programs are used is the type of transaction for which the programs were developed. Where the programs were designed to aid Titleserv in ordering its transactions with client banks, an adaptation which allows the programs to be accessed directly through a dial-up connection by the client bank, rather than exclusively by Titleserv's personnel at the request of the client bank, does not seem to us to violate § 117(a)(1)'s "in no other manner" requirement. It is not as if Titleserv made the programs available to clients to use in their own transactions independent of Titleserv. Titleserv simply increased the versatility of the programs by allowing them to report on Titleserv's transactions with its clients either at the direction of Titleserv personnel or of the client. This constitutes use in the *same* manner, with the benefit of an adaptation increasing versatility.

We conclude that Titleserv demonstrated entitlement to summary judgment under § 117(a). In the terms of § 117(a), it was "not an infringement" for Titleserv, as the "owner of a copy of a computer program to make . . . [an] adaptation" where such adaptation was "created as an essential step in the utilization of the computer program in conjunction with a machine and . . . it [was] used in no other manner."

CONCLUSION

The judgment of the district court is affirmed.

APPENDIX B

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

(98-CV-5756) (TCP) (WDW)

WILLIAM KRAUSE d/b/a SPECIAL-T SOFTWARE,

Plaintiff,

—against—

TITLESERV, INC., NEW YORK SETTLEMENT CORP., JAMES J. CONWAY, III, DAVID EISENBERG, KENNETH WODISKA and THOMAS MURPHY,

Defendants.

MEMORANDUM AND ORDER

PLATT, District Judge.

Before the Court is a Report and Recommendation of Magistrate Judge William D. Wall dated August 7, 2003 (the "Report") granting defendants Titleserv, Inc.; New York Settlement Corp.; and James J. Conway, III, David Eisenberg, Kenneth Wodiska and Thomas Murphy (collectively, "Titleserv" or "Defendants") summary judgment against plaintiff William Krause ("Krause" or "Plaintiff") on the latter's claim of copyright infringement. For the following reasons, the Report is AFFIRMED and ADOPTED as an Order of this Court.

BACKGROUND

The background of this dispute is more fully set forth in Magistrate Wall's Report, and the Court will assume familiarity with both the Report and earlier decisions in this case. Briefly, Krause is a computer programming consultant who performed work for Titleserv, a title service agency, between 1986 and 1996. Plaintiff's work for Defendants included creating over 35 computer programs; programs which constitute Defendants' operating systems and eight of which are at issue in this case. Upon the termination of Krause's relationship with Titleserv, Plaintiff took the source codes for two of the programs with him, limiting Defendants' ability to modify these programs to include the ability to add new client information to Titleserv's records.

Following Mr. Krause's departure, Titleserv filed a still-pending State suit against him for return of the source codes. Krause responded by seeking copyright protection for his programs. Meanwhile, Titleserv successfully reverse-engineered the programs Krause created, enabling Titleserv to modify the source codes and add new client information. Krause responded by filing the instant action for copyright infringement.

Defendants subsequently moved for summary judgment against Plaintiff. Magistrate Judge Wall's Report, requested by this Court, recommended finding Defendants' motion for summary judgment. The Report accepted Titleserv's theory that its use and modification of Krause's program was an authorized modification of Plaintiff's program, as protected by 17 U.S.C. § 117, because Titleserv owned a copy of the programs and only adapted them as an essential step in their utilization. Plaintiff filed objections to the

Report on August 25, 2003, and Defendants filed limited objections the same day.

Discussion

A. Summary Judgment

Summary judgment may be granted if, after resolving all ambiguities and drawing all inferences in favor of the non-moving party, the moving party demonstrates that there are no genuine issues of material fact, and that they are entitled to judgment as a matter of law. *See* FED. R. CIV. P. 56(c); *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 255 (1986); and *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586 (1986). Material facts are those which may affect the outcome of the case, and a factual dispute is genuine where a reasonable jury may return a verdict for the non-moving party. *See Anderson*, 477 U.S. at 248.

At "the summary judgment stage the judge's function is not himself to weigh the evidence and determine the truth of the matter but to determine whether there is a genuine issue for trial." *Id.* at 249. Yet summary judgment is appropriate against a party who fails to establish an element essential of the case as to which that party will bear the burden of proof at trial (*see Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986)); and when "the moving party has carried its burden under Rule 56(c), its opponent must do more than simply show that there is some metaphysical doubt as to the material facts." *Matsushita*, 475 U.S. at 586.

Plaintiff's claim of copyright infringement

Krause claims Defendants violated the copyrights on the programs he created, while Defendants claim that the copyright laws specifically protected their actions. Section 117 of Title 17 of the United States Code states that it is not a copyright infringement for the owner of a copy of a computer program to make a copy or adaptation of that program "provided that such a new copy or adaptation is created as an essential step in the utilization of the computer program in conjunction with a machine and that it is used in no other manner. . . ." 17 U.S.C. § 117(1). Magistrate Judge Wall's Report found, under Section 117, as interpreted within the Second Circuit by that Court's decision in *Aymes v. Bonelli*, 47 F.3d 23 (2d Cir. 1995), that Titleserv owned a copy of Krause's programs and made adaptations to the programs that were essential to the program's utilization in Defendants' business. The Report recommended that summary judgment be granted to Titleserv, and Krause objects to this finding.[1]

A. *Defendants' ownership of copies of Plaintiff's programs*

Krause received in excess of $350,000 from Titleserv, leading Magistrate Judge Wall to find that "at the very least, Titleserv owned a copy of the program." (Report at 9-11.) Plaintiff admits performing "numerous services" for Defendants, including, *inter alia*, "creating and developing its computer software systems." (Plaintiff's Objections at

[1] The Report rejected Defendants' alternative grounds for summary judgment: that either Plaintiff reached a verbal nonexclusive license agreement with Defendants, or that Plaintiff failed to establish ownership of the copyrights to the programs in the first instance.

21.) However, Krause argues that, because Titleserv's proofs of his compensations, Internal Revenue Service forms, do not specify which portion of this sum was directly related to programming activities he performed for Defendants, as opposed to unspecified materials he provided to them, there is a disputed issue of material fact regarding his compensation for his programming activities and of Titleserv's ownership of the programs. (*See* Plaintiff's Objections at 20-24.)

Nowhere does Plaintiff suggest that his relationship with Titleserv was primarily that of a supplier of materials to Defendants, and Krause admits that "it would now be impossible for him to determine what portion of the [tax statements] related to his services, as opposed to parts and services." (Plaintiff's Objections at 22.) Krause is a self-described "independent business analyst, computer consultant and computer programmer." (Plaintiff's Objections at 1.) Plaintiff suggests that Magistrate Judge Wall may not determine from the evidence presented that Krause, a computer programmer, was paid over $350,000 at least in part for computer programming services. Even resolving all ambiguities and drawing all inferences in favor of Plaintiff, there is no genuine issue of material fact regarding Krause's payment by Titleserv to develop computer programs nor of Titleserv's ownership of copies of these programs.[2]

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[2] Krause's objections regarding the alleged existence of a [*sic*] oral licensing agreement, as opposed to an ownership agreement, pertaining to the programs, are also unavailing. Assuming that such an oral agreement existed, it would be invalid under the Copyright Act's statute of frauds.

B. *Defendants' adaptations to Plaintiff's programs*

The Report found that Titleserv's modifications of Krause's programs were an essential step in the utilization of Plaintiff's program in conjunction with Defendants' machines. (*See* Report at 11-15.) Krause objects, arguing because a sister company of Titleserv, New York Settlement Corp. ("Settlement"), used the modifications to one of the programs, the modifications were not essential to Titleserv. (*See* Plaintiff's Objections at 6, 12.) This argument is not persuasive—Titleserv and Settlement are owned and operated by the same individual, James J. Conway, III ("Conway"). Titleserv is a title service agency, Settlement is a mortgage services agency, and their work for their co-owner and operator, Conway, is complementary. Furthermore, Titleserv, Settlement and Conway are all named as joint defendants in Krause's suit. There is no genuine [*sic*] of disputed material fact, on the basis of the different corporate personae involved, regarding the modifications of Plaintiff's programs being essential to the programs' utilization by Defendants.

Krause also argues, citing the legislative history of the 1976 Report of the National Commission on New Technological Uses of Copyrighted Works, in combination with developments in computer science over the past quarter century (*see* Plaintiff's Objections at 8-10), that § 117 does not allow Titleserv to modify Plaintiff's programs in order to utilize the programs to advance Defendant's business interests, but merely to "permit the program to run on the users machine due to the lack of standardization that was once prevalent in the computer industry." (Plaintiff's Objections at 13.)

Titleserv is a business. It is unclear why Defendants would contract with and pay Plaintiff hundreds of thousands of dollars to develop computer programs, other than to advance Titleserv's business interests. Nothing in Plaintiff's objections overrides the plain language of § 117, which allows an owner of a computer program to adapt that program as an essential step in the utilization of the program in conjunction with a machine. There is no limiting language to § 117 that debars an owner from making modifications for business purposes.

This reading of § 117 is directed by the Second Circuit's decision in *Aymes v. Bonelli*, 47 F.3d 23 (2d Cir. 1995). In *Aymes*, the Second Circuit found that the plaintiff, a computer programmer, "was paid by [the defendant] to design a program specifically for [the defendant]'s use, and for those efforts he earned in excess of $70,000. The [Defendant], therefore, had a right to use the program for its own business purposes"—in that case, for the updating of "the inventory, record-keeping, and sales efforts in [the defendant]'s business." *Id.* at 24-25. Titleserv's purposes for modifying Krause's programs in the instant case are similar to the defendant's purpose for modifying the plaintiff's program in *Aymes*: to update records for business purposes.

The changes made by the defendant to the plaintiff's computer program in *Aymes*

> were necessary measures in their continuing use of the software in operating their business . . . copyright laws should reflect the fact that transactions involving computer programs are entered into with full awareness that users will modify their copies to suit their own needs . . . This right of adaption [*sic*] includes the right to add fea-

> tures to the program that were not present at the time of rightful acquisition, and was intended to apply to modifications for internal use, as long as the adapted program is not distributed in an unauthorized manner.

Id. at 26 (internal citations and quotation marks omitted).

Plaintiff, in his objections to the Report, goes to great lengths to distinguish the facts of the case at bar from those in *Aymes*. (*See* Plaintiff's Objections at 13-15.) *Aymes*, as Krause suggests, may indeed be superficially distinguished from the instant case—e.g., the number of computers involved, the originality of the computer program in question, or the type of modifications made—but any single case is factually distinguishable from another. Yet the holding of *Aymes* is still controlling law in the Circuit, is applicable to this case, and was correctly applied in Magistrate Judge Wall's Report.[3]

C. *Defendants' "Use in No Other Manner" of Plaintiff's programs*

Plaintiff's single objection to the Report that bears further scrutiny is that Titleserv, in violation of the limited exception carved out by § 117, allowed Krause's programs, as modified by Titleserv, to be used in another manner by sharing the programs with outsiders. Krause states that Titleserv allowed the programs to be "used by two of

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[3] *See Ez-Tix, Inc. v. Hit-Tix*, 969 F. Supp. 220, 224 (S.D.N.Y. 1997) (citing *Aymes* for the proposition that "the purchaser of a computer program has a right to use that program for its own business purposes"); *see also Applied Info. Mgmt., Inc. v. Icart*, 976 F. Supp. 149, 152 (E.D.N.Y. 1997) (citing *Aymes* for the proposition that "Section 117 applies to modifications for internal use").

[Defendants'] clients banks, Chase Manhattan and Bank of New York." (*See* Plaintiff's Objections at 17.) If so, this might be a disputed issue of material fact to be further explored at trial.

However, a closer examination of the record, *sua sponte*, bears out that Titleserv did not share the programs with these banks; e.g., it did not allow the banks to copy the source codes of these programs. Defendants merely allowed the two banks "dial-up" access to view client records on Titleserv's computer systems, and only for a period of one year. (*See* Plaintiff's Objections, Exhibit N (Mr. Murphy's deposition at pages 143:10-144:11).) This is not a prohibited use of the programs that would place Defendants outside the ambit of § 117's affirmative defense.

Defendant's cross-motion for sanctions

The Report also denied Defendants' renewed cross-motion for sanctions against Plaintiff pursuant to this Court's order of August 15, 2003 denying Plaintiff's motion for default judgment. Titleserv objected to this aspect of the Report, and requested that the Report be modified to recommend that Defendant's cross-motion be denied without prejudice to renew. In a Supplemental Report and Recommendation of September 10, 2003, Magistrate Judge Wall denied Defendants' request, noting that while "several of the motions made by plaintiff can be characterized as ill-advised . . . the court finds that, in the context of this case, the plaintiff's conduct is not sanctionable." This Court agrees.

For the reasons stated above, Magistrate Judge Wall's Report and Recommendation of August 7, 2003, as well as

the amended Report and Recommendation of September 10, 2003 are therefore ADOPTED as Orders of this Court.

CONCLUSION

Summary judgment is GRANTED for Defendants as to Plaintiff's claim of copyright infringement, and this claim is according [*sic*] DISMISSED. Defendants' renewed cross-motion for sanctions against Plaintiff is DENIED.

SO ORDERED.

/s/ THOMAS C. PLATT
Thomas C. Platt, U.S.D.J.

Dated: Central Islip, New York
October 30, 2003

APPENDIX C

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

98-CV-5756 (TCP) (WDW)

WILLIAM KRAUSE d/b/a SPECIAL-T SOFTWARE,

Plaintiff,

—against—

TITLESERV, INC., NEW YORK SETTLEMENT CORP., JAMES J. CONWAY, III, DAVID EISENBERG, KENNETH WODISKA and THOMAS MURPHY,

Defendant(s).

REPORT AND RECOMMENDATION

WILLIAM D. WALL, United States Magistrate Judge:

Before the court are a motion for summary judgment and a motion for sanctions, both made by defendants ("collectively "Titleserv"). Those motions were referred to the undersigned by Judge Thomas Platt for report and recommendation. Papers were submitted and oral argument held on May 12, 2003. For the reasons set forth herein, it is recommended that Titleserv's motion for summary judgment be granted, and that the motion for sanctions be denied.

BACKGROUND

Defendant Titleserv, Inc. is a title insurance agency that originates and services title insurance orders for underwriters. Def. Rule 56.1 Statement ¶ 1. In 1996, it was the largest title service company on Long Island. Aneser Ex. 21, Conway Aff. ¶ 6. Defendant New York Settlement Corp. services the lending community by providing mortgage closers and other related services. Id. at ¶ 7. Defendant James J. Conway III is the sole owner and CEO of Titleserv and New York Settlement Corp. Def. Rule 56.1 Statement ¶ 3. Defendants David Eisenberg and Kenneth Wodiska were employed as computer programmers at Titleserv. Def. Rule 56.1 Statement ¶¶ 4 & 5. Plaintiff William Krause is a computer programmer who commenced doing consulting work for Titleserv in 1986. Aneser Ex. 14, Krause Aff. ¶¶ 3 & 4. He formed Special-T Software in or about 1986. Berman Ex. C, Krause Dep. p. 32. In addition to his programming work at Titleserv, Krause maintained the telephone and communications systems, conducted computer training for staff, and maintained computer hardware and software. Berman Ex. C, Krause Dep. p. 427. The issue of whether Krause was an independent contractor or employee of Titleserv is disputed. For purposes of this motion only, Titleserv allows that Krause was an independent contractor, the position taken by plaintiff.

In 1991, Krause took office space within Titleserv's offices. Aneser Ex. 16, Krause Aff. ¶ 19. Krause performed programming work on his own notebook computer while at the Titleserv offices, then installed new versions of the completed programs on Titleserv's network. Id.; Aneser Ex. 4, Defendants' First Request for Admissions No. 13. The source code was kept separate and could only be modified by Krause. Aneser Ex. 8, Krause Dep. p. 326.

Source code is the form in which a programmer writes a computer program in a programming language such as COBOL or C++. *See Computer Assocs. Int'l, Inc. v. Altai, Inc.*, 982 F.2d 693, 698 (2d Cir. 1992). In this case, the source code was written in the DOS-based Clipper programming language. Def. Rule 56.1 Statement ¶ 12. The source code typically includes the programmer's comments, written in English (or in the programmer's speaking language), which are used to record the functions for particular lines of code or other documentation desired by the programmer. Before a user can run the program, the source code is run through a compiler that strips out the comments and converts the source code into binary executable code, sometimes called object code. *See Computer Assocs.*, 982 F.2d at 698. The executable code, which is not human-readable, is the version of the program that actually runs on the computer. *See Softel, Inc. v. Dragon Med. & Scientific Communications, Inc.*, 118 F.3d 955, 959 fn 3 (2d Cir. 1997), *cert. denied*, 523 U.S. 1020 (1998). In this Report, the term "programs" generally includes both source code and executable versions. Where distinctions are necessary, reference will be made to the specific type of code.

During his relationship with Titleserv, Krause created over 35 computer programs. Defendants' Rule 56.1 Statement ¶ 10. These programs collectively made up Titleserv's computer systems.[1] Aneser Ex. 16, Krause Aff. ¶ 7. These programs enable Titleserv to run its title service business by "tracking and reporting on the status of thousands of active files . . . with respect to the various lenders and clientele

[1] Only eight programs are at issue in this case. They are named NYSMAIN, LISTALL, APTRACK, CLOSMAIN, BOOKMAIN, CHASMAIN, RATEMAIN, and TAX. Aneser Ex. 2, Amended Complaint.

being serviced." Aneser Ex. 21, Conway Aff. ¶9. The main operating system, NYSMAIN, was developed for Titleserv by Krause in 1994. Aneser Ex. 14, Krause Aff. ¶14. Between 1992 and 1996, Titleserv paid Krause over $364,000. Aneser Ex. 26.

On July 10, 1996, Krause terminated his relationship with Titleserv. Def. Rule 56.1 Statement ¶14. At that time, while executable versions of the programs and some source code remained on Titleserv's network, Krause took the source code for the NYSMAIN and RATEMAIN programs that were stored on his notebook computer. Berman Ex. C, Krause Dep. P. 406-07. The parties dispute what was taken by Krause in addition to the source code, and the extent of damage to Titleserv's business occasioned by Krause's departure. Titleserv has claimed that Krause took all the passwords and that the systems were locked. Aneser Ex. 21, Conway Aff. ¶¶2 & 3. Krause repeatedly represents that upon his departure, the programs were "fully operational" and Titleserv had all it needed to run its business. Aneser Ex. 14, Krause Aff. ¶19; Aneser Ex. 15, Krause Aff. ¶27. The only limitation on Titleserv's use of NYSMAIN after Krause's departure, according to him, was that the program could not be modified. Aneser Ex. 15, Krause Aff. ¶27. While Titleserv had the executable programs on its servers and could run them, the programs were designed in such a way that any *additions* to Titleserv's clients required modification of the source code, which Krause took with him. The highest priority at Titleserv was to be able to add new clients to NYSMAIN and "[t]hose were the changes that were necessary, the software modules that we had to change." Aneser Ex. 12, Murphy Dep. p. 146. In order to make those necessary changes, Titleserv needed access to the source code.

Faced with this limitation, after Krause's departure, Titleserv personnel got access to the source code by reverse engineering or decompiling the executable programs in their possession into editable source code. Berman Ex. K, Wodiska Dep. p. 34. Over time, Titleserv personnel developed a new, Windows-based system that interacted with the old system and used data converted from the old system. Id. p. 54. Titleserv stopped using the old system by late 1997 or early 1998. Berman Ex. J., Eisenberg Dep. p. 312. The decompiled source code was used by Titleserv until the new system was phased in. Berman Ex. J, Eisenberg Dep. p. 229.

On July 16, 1996, shortly after Krause's departure, Titleserv commenced an action in New York State Supreme Court seeking return of all the source code, passwords, and access codes. Aneser Ex. 17. To the court's knowledge, the state court action is still pending. Starting on July 22, 1996, Krause began registering seven of the eight programs at issue for copyright protection.[2] Aneser Ex. 2, Amended Complaint ¶ 12. In September 1998, Krause instituted the current action, asserting several causes of action. Aneser Ex. 1, Complaint. On January 26, 1999, Krause amended the complaint to include a single cause of action against defendants for copyright infringement "by their unauthorized reproduction and derivative works of the computer programs." Aneser Ex. 2, Amended Complaint ¶ 16.

After the conclusion of the discovery, plaintiff made a motion for default pursuant to Fed. R. Civ. P. 37(b)(2) to District Judge Platt, citing defendants' failure to comply with an earlier discovery order. That motion sought an

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[2] Krause had registered one of the programs, LISTALL, in 1986. The programs Krause wrote for Titleserv were based upon the LISTALL program. Aneser 16, Krause Aff. ¶ 7.

order granting judgment by default against defendants, striking defendants' pleadings, and refusing to allow the defendants to oppose plaintiff's claims of copyright infringement. Defendants cross-moved for sanctions and moved for summary judgment. Judge Platt denied all the motions on February 22, 2002 without prejudice to renew and referred the issue of whether defendants had defaulted on their discovery obligations to the undersigned. The undersigned issued a report and recommendation on June 5, 2002 that recommended there be no finding of default against defendants. Judge Platt adopted that recommendation in an order dated August 15, 2002 and plaintiff's motion for reconsideration of that order was denied on October 8, 2002. Defendants have herein renewed their motions for sanctions and for summary judgment.

DISCUSSION

Plaintiff's Amended Complaint contains a single cause of action for copyright infringement and seeks both injunctive and monetary relief. Defendants have advanced three separate theories under which they claim entitlement to summary judgment.

I. Summary Judgment Standards

"'Summary judgment is appropriate where there are no genuine disputes concerning any materials facts, and where the moving party is entitled to judgment as a matter of law.'" *Jamaica Ash & Rubbish Removal Co. v. Ferguson*, 85 F. Supp. 2d 174, 180 (E.D.N.Y. 2000) (quoting *In re Blackwood Assocs., L.P.* 153 F.3d 61, 67 (2d Cir. 1998) and citing Fed. R. Civ. P. 56(c) and *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986)). In deciding a summary

judgment motion, the district court must resolve all ambiguities and draw all reasonable inferences in the light most favorable to the opposing party. *See Castle Rock Entm't, Inc. v. Carol Publ'g Group, Inc.*, 150 F.3d 132, 137 (2d Cir. 1998). If there is evidence in the record as to any material fact from which an inference could be drawn in favor of the non-movant, summary judgment is unavailable. *See Holt v. KMI-Continental, Inc.*, 95 F.3d 123, 128 (2d Cir. 1996), *cert denied*, 520 U.S. 1228 (1997).

The trial court's responsibility is "'limited to discerning whether there are any genuine issues of materials fact to be tried, not to deciding them. Its duty, in short, is confined at this point to issue-finding; it does not extend to issue-resolution.'" *B.F. Goodrich v. Betkoski*, 99 F.3d 505, 522 (2d Cir. 1996) (quoting *Gallo v. Prudential Residential Servs., L.P.*, 22 F.3d 1219, 1224 (2d Cir. 1994)). When, however, there is nothing more than a "metaphysical doubt as to the material facts," summary judgment is proper. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586 (1986). "Rather, there must exist 'specific facts showing that there is a genuine issue for trial' in order to deny summary judgment as to a particular claim." *Jamaica Ash & Rubbish*, 85 F. Supp. 2d at 180 (quoting *Celotex*, 477 U.S. at 322)). In opposing a motion for summary judgment, "[c]onclusory allegations, conjecture, and speculation are 'insufficient to create a genuine issue of fact.'" *Dienes Corp. v. Long Island Rail Road Co.*, No. 01-CV-4272, 2002 WL 603043, at *2 (E.D.N.Y. Mar. 19, 2002) (quoting *Kerzer v. Kingly Mfg.*, 156 F.3d 396, 400 (2d Cir. 1998) (citations omitted)); *see also O'Hara v. Weeks Marine, Inc.*, 928 F. Supp. 257, 259 (E.D.N.Y. 1996) ("[c]onclusory allegations unsupported by factual data cannot raise a genuine issue for trial").

With these standards in mind, the court will separately consider the three theories advanced by defendants in support of their motion for summary judgment.

A. Defendants' use and modification as of right under 17 U.S.C. § 117:

Titleserv argues that even if Krause was acting as an independent contractor and thus holds the copyrights to the programs, Titleserv did not infringe those copyrights since it was entitled to use and modify the programs pursuant to 17 U.S.C. § 117. Section 117 reads, in pertinent part:

> Notwithstanding the provisions of section 106, it is not an infringement for the owner of a copy of a computer program to make or authorize the making of another copy or adaptation of that computer program provided:
>
> (1) that such a new copy or adaptation is created as an essential step in the utilization of the computer program in conjunction with a machine and that it is used in no other manner . . .

Thus, to prevail on its motion for summary judgment, Titleserv must establish that it owned a copy of the programs and that the changes made to them were an essential step in their utilization.

i. Ownership of a copy of the programs

Support for Titleserv's position that it owned a copy of the programs comes largely from the *Aymes*[3] cases, partic-

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[3] *Aymes v. Bonelli*, No. 85 Civ. 2228, 1991 WL 195975 (S.D.N.Y. Sept. 25, 1991), *on reconsid.*, 1991 WL 243376 (S.D.N.Y. Nov. 12,

ularly *Aymes v. Bonelli*, 47 F.3d 23 (2d Cir. 1995) (hereinafter "*Aymes II*"). The plaintiff in *Aymes* designed computer programs for defendant Island Recreation for use in its internal business processing. In an earlier decision in that case, the Second Circuit found as a matter of law that plaintiff Aymes was an independent contractor and remanded the case for a determination in Aymes's infringement claim. *Aymes v. Bonelli*, 980 F.2d 857, 865 (2d Cir. 1992). The court also noted that although the plaintiff owned the copyrights, the defendant owned a copy of the program and had the clear right to use it. *Id.* at 864-65. Titleserv argues that, accepting Krause's claim that he was an independent contractor and owned the copyrights, Titleserv, like the defendant in *Aymes*, owned a copy of the programs.

Krause argues that any reliance upon the *Aymes* cases is misplaced because those cases contain no recitation of facts supporting the district judge's finding that Aymes sold a copy of the program to Island. The court assumes this to be an argument that, under the undisputed facts in this case, Titleserv did not "own a copy" of the programs for purposes of § 117. The court disagrees and finds that the undisputed facts in this case, which are strikingly analogous to the *Aymes* facts, lead inevitably to the conclusion that Titleserv did own a copy of the programs for § 117 purposes.

In *Aymes II*, the court noted that "even as an independent contractor, Aymes was paid by Island to design a program specifically for Island's use." *Aymes II*, 47 F.3d at 25. Krause has stated that his role at Titleserv was "the design,

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1991), *rev'd and remanded*, 980 F.2d 857 (2d Cir. 1992), *on remand*, 1994 WL 97026 (S.D.N.Y. Mar. 24, 1994), *aff'd*, 47 F.3d 23 (2d Cir. 1995).

creation and implementation of systems" Aneser Ex. 16, Krause Aff. ¶30, and that he developed the NYSMAIN program for Titleserv. Aneser Ex. 14, Krause Aff. ¶14. Krause acknowledges that "[t]he software was customized for Titleserv's operations." Aneser Ex. 8, Krause Dep. p. 376.

The plaintiff in *Aymes* was paid to design programs "and for those efforts he earned in excess of $70,000." *Aymes II*, 47 F.3d at 25. Titleserv has shown that Krause was paid in excess of $364,000 for his services over a five-year period. Aneser Ex. 26. Krause does not dispute that he was paid for his services,[4] but rather seems to argue that Titleserv has not proved what portion of that payment was specifically for the programs. If Krause's suggested argument is that Titleserv did not pay him for the computer programs, he offers no evidence to support a finding that those amounts did not include payments for Krause's work as a computer programmer. On a motion for summary judgment, "the movant's burden will be satisfied if he can point to an absence of evidence to support an essential element of the nonmoving party's claim." *Goenaga v. March of Dimes Birth Defects Found.*, 51 F.3d 14, 18 (2d Cir. 1995). Krause has not presented any evidence whatsoever to support the suggestion that he was not paid for creating the programs, and the court finds that he was paid.

The *Aymes* defendant, Island, ran its copy of the program on its computer, and relied upon the program to run its business by record-keeping, tracking inventory, and sales activities. *Aymes II*, 47 F.3d at 24. The uses for the programs were internal and Island did not distribute the

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[4] In response to Defendants' First Request for Admissions, Krause denied that he was "paid," but admits that he received "nonemployee compensation in an amount in excess of $350,000." Aneser Ex. 4, Defendants' First Request for Admissions No. 16.

programs to third parties. *Id.* at 27. Similarly, Titleserv ran its copy of the programs at issue in this case on its computers. Berman Ex. C., Krause Dep. p. 406. The programs were used to run its business by tracking and reporting on the status of title searches and related services. Aneser Ex. 21, Conway Aff. ¶¶ 6-9. There is no allegation that Titleserv distributed the programs to third parties.

In sum, like the plaintiff in *Aymes*, Krause wrote the programs specifically for Titleserv's use. Like the *Aymes* plaintiff, Krause was compensated for this service. Like the *Aymes* defendants, Titleserv ran its copy of the programs on its computers, relied on the programs to run its business, and did not distribute its copy of the programs to third parties. As in *Aymes*, Krause "cannot realistically dispute the fact that he sold defendants the computer program and that defendants are therefore rightful owners" of a copy of the program. *Aymes II*, 47 F.3d at 25 (quoting the district court's finding). Application of § 117 and the principles set forth by the Second Circuit in the *Aymes* cases requires not that Titleserv prove it owned the programs themselves or the copyrights, merely that it owned *a copy* of the programs. The undisputed facts in this case thus support a finding that, at the very least, Titleserv owned a copy of the program and accordingly, the first requirement of § 117 is met.

Krause cites only one case to oppose *Aymes*, *DSC Communications Corp. v. Pulse Communications, Inc.*, 170 F.3d 1354 (Fed. Cir.), *cert. denied*, 528 U.S. 923 (1999). In that case, the parties entered into a written licensing agreement that included various restrictions, including an express characterization of the licensees as non-owners of copies of the software. *Id.* at 1361. There is nothing in the record to suggest that Krause and Titleserv had any such agreement, and thus the *DSC Communications* case is readily distinguish-

able. It is undisputed that there was no was no written agreement at all between Krause and Titleserv, and, to the extent that Krause suggests that there was an oral agreement governing the licensing of the programs,[5] nothing in the record gives rise to an inference that any oral agreement contained an express provision barring Titleserv's ownership of a copy of the programs, as was the case in *DSC Communications*.

The court finds that on the undisputed facts, Titleserv at the very least owned a copy of the programs.[6] Having made such a determination, the court now turns to the second requirement of § 117, that is, whether the modifications made were an essential step in the utilization of the programs.

ii. Adaptations as an essential step in the utilization of the programs

As with the ownership issue, the *Aymes II* case is persuasive on the issue of whether the modifications made by Titleserv were an essential step in the utilization of the programs and thus permissible under § 117. In *Aymes II*, the Second Circuit discussed at length the legislative history behind § 117 which "was implemented to follow 'the recommendations of the National Commission on New Technological Uses of Copyrighted Works [the "CONTU"]

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[5] As explained in section iii, *infra*, pursuant to the the [*sic*] Copyright Act, any oral license that might be inferred from the record is barred by 17 U.S.C. § 204.

[6] While the motions currently before the court do not explicitly seek a determination as to which party owns the copyrights to the programs, implicit in the conclusion that Titleserv owned a copy of the programs is a finding that Krause owned the copyrights to the programs themselves. If this Report is not adopted, however, the ownership of the copyrights will remain an open question.

with respect to clarifying the law of copyright ownership of computer software." *Aymes II*, 47 F.3d at 26 (citing H.R. Rep. No. 1307, 96th Cong., 2d Sess., Pt. I, 15 23 (1980)). The Second Circuit took notice of CONTU's final report that stated "[b]uyers should be able to adapt a purchased program for use on the buyer's computer because without modifications, the program may work improperly, if at all. No buyer would pay for a program without such a right." *Aymes II*, 47 F.3d at 26 (citing Final Report of the National Commission on New Technological Uses of Copyrighted Works 30, 32 (1978) ("CONTU Report")). Applying these principles in *Aymes*, the court concluded that the changes made by Island to its copy of the program were "necessary measures in their continuing use of the software in operating their business" and thus "fall easily within the contempation [*sic*] of Contu." *Aymes II*, 47 F.3d at 26. The same is true of the changes made by Titleserv.

The *Aymes* cases hold that an owner of a copy can alter or modify that copy to the extent of converting the program to a different computer language and adding features that did not exist in the original software. *Aymes II*, 47 F.3d at 26-27, citing CONTU Report at 13-14. "This right of adaptation includes 'the right to add features to the program that were not present at the time of rightful acquisition,' . . . and was intended to apply to modifications for internal use, as long as the adapted program is not distributed in an unauthorized manner." *Aymes II*, 47 F.3d at 15, 26 (quoting *Foresight Res. Corp. v. Pfortmiller*, 719 F. Supp. 1006, 1009-10 (D. Kan. 1989)). In *Aymes II*, the Second Circuit determined that Island's actions in modifying and eventually creating derivative works from the programs at issue fell within § 117 and thus did not constitute copyright infringement. The permissible modifications

included adaptations to keep the software current regarding late charge provisions as well as modifications made necessary when defendant upgraded its computers. *Aymes II*, 47 F.3d at 26. Furthermore, the modifications were not made for any purpose other than the company's internal business needs and thus were permitted under § 117.

The principles espoused in the CONTU Report and applied in the *Aymes* cases are readily applicable to the facts in this case. Since the design of the programs was such that new clients could only be added at the source code level, Titleserv had to modify the source code in order to advance its business and add new clients.[7] The continued use of the programs in the business was dependent upon Titleserv's ability to perform this function. Without the modifications, the programs would have been useless to Titleserv, and without the programs, Titleserv would not be able to quickly process title applications, thus affecting its business. The court concludes that the ability to make such modifications was essential to the utilization of the programs in support of Titleserv's business interests and thus allowable under § 117 and *Aymes II*.

Titleserv later created a version of the program in a different programming language. To the extent such a program constituted a derivative work, the permissibly of such an adaptation pursuant to § 117 is also supported by *Aymes*. *Aymes II*, 47 F.3d at 25, 26, Finally, there is no sug-

[7] An analogy to Titleserv's situation would be having a word processing program that only allowed the initial creation of documents by a programmer at the source code level. A user would not be prevented from working on existing documents using the executable versions of the program, but he would be unable to create new documents without the programmer's modifications to the source code. Clearly it would be essential to have access to the source code to create new documents and thus run the business.

gestion that Titleserv distributed the programs or used them in any way other than in the pursuit of its own business. *See RAV Communications, Inc. v. Philipp Bros., Inc.*, No. 87 Civ. 3366, 1988 WL 36174, at *2 (S.D.N.Y. April 13, 1988) ("§ 117 should be given a broader reading where the owner of a copy of a computer program adapts it for his own internal use").

The court thus concludes that based on the undisputed facts, Titleserv not only owned a copy of the programs, but made adaptations to them that were essential to their utilization in Titleserv's business.

iii. Existence of a licensing agreement

As mentioned earlier, Krause cites only one case, *DSC Communications*, in opposition to *Aymes*. He argues that "as in *DSC Communications*, [p]laintiff placed severe restrictions on defendants' use of the computer programs. This is borne out by defendants' own admissions." Mem. in Opp., p. 5. While these two sentences constitute the complete argument advanced by Krause to distinguish *Aymes*, it appears that he is suggesting that Titleserv was never an owner of the software, merely a licensee, and as such, § 117 should not apply. The CONTU Report notes that "[s]hould proprietors feel strongly that they do not want rightful possessors of copies of their programs to prepare such adaptations, [as allowed by § 117] they could, of course, make such desires a contractual matter." *Aymes II*, 47 F.3d at 26 (quoting the CONTU Report at 13-14). Krause's argument, however, is not supported by the citations provided. In support of his claim, plaintiff cites 41 subparts of his Rule 56.1 Counter-statement. Although the court laboriously reviewed each subpart as well as the evidence cited in each, it found not a single "admission" by

defendants that they were bound by contractual restrictions regarding the use of the programs.

Despite the lack of briefing provided by Krause and his failure to make a viable argument regarding the existence of any licensing agreement, on this motion for summary judgment, the court has *sua sponte* reviewed the record for evidence of such an agreement. It is undisputed that the parties did not enter into a written agreement. Instead, Krause repeatedly testified that Titleserv had a verbal, "exclusive license to use such programs" for the duration of their business relationship. Aneser Ex. 15, Krause Aff. ¶ 14; *see also* Aneser Ex. 8, Krause Dep. p. 128, 131; Aneser Ex. 1, Complaint ¶ 29. The agreement was exclusive "because [Conway] didn't want me to sell the programs to his competitors or license them to his competitors which I agreed to." Krause Dep. p. 129.

Even accepting Krause's testimony that an oral exclusive license existed, however, such an agreement is barred by the statute of frauds provision in copyright law, which provides that an exclusive license must be in writing. 17 U.S.C. § 204(a) ("transfer of copyright ownership . . . is not valid unless an instrument of conveyance, or a note or memorandum of the transfer, is in writing"); *see also* 17 U.S.C. § 101 (includes exclusive license in the statutory definition of a "transfer of copyright ownership").[8] Accordingly, the purported license testified to by Krause was unenforceable and the court finds as a matter of law that there was no license regarding the use of the computer programs.

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[8] While the requirement of a writing may have been designed primarily to protect the copyright holder, considerations of equity require that the protection run both ways.

The court further notes that even if a verbal, exclusive agreement was permissible under the copyright law, Krause has provided no evidence whatsoever to support the existence of a contractual *term* that allows Titleserv to use the programs, but not modify the source code to allow for the entry of new clients. According to Krause's testimony, Titleserv "had a license to use the executable program that they were using. That license didn't go away. What went away was their rights to modify the programs." Aneser Ex. 8, Krause Dep. at 123-24. This alleged contractual term flies in the face of reason since the inability to modify the programs to add new clients would render the programs immediately obsolete. On a motion for summary judgment, the "litigant opposing summary judgment may not rest upon mere conclusory allegations or denials, but must bring forward some affirmative indication that his version of relevant events is not fanciful." *Podell v. Citicorp Diners Club, Inc.*, 112 F.3d 98, 101 (2d Cir. 1997) (internal quotations omitted). Based upon his testimony alone, Krause would have a jury believe that Titleserv entered into an agreement wherein it paid him tens of thousands of dollars to develop a computer program to track its title insurance business with the understanding that Titleserv would never be able to add new clients after Krause ended his association with the company. No reasonable trier of fact could conclude, having only Krause's unsupported assertion, that Titleserv would agree to such a contractual term. *See, e.g., Viacom Int'l Inc. v. Fanzine Int'l Inc.*, No. 98 Civ. 7448, 2000 WL 1854903, at *3 (S.D.N.Y. July 5, 2000) (noting that "no reasonable juror could conclude that the parties manifested mutual assent to a licensing arrangement giving defendant unfettered, and free, permission to exploit" the copyrighted materials). Title-

serv, as the moving party, "is not required to affirmatively disprove unsupported assertions made by the non-movant." *Dienes Corp.*, 2002 WL 603043, at *2 (citing *Celotex*, 477 U.S. 317, 323 (1986)).

In fact, Krause has provided testimony that such a term did not exist:

> Q: But did you ever explain to anyone at Titleserv that when you left, they would not be entitled to work with the source code?
> A: Not in so many words, no.
> Q: How about in any words?
> A: Mr. Conway didn't listen to anything I said.
> Q: Did you have that discussion or not?
> A: Sure, yes.
> Q: You specifically told people at Titleserv that they would not be entitled to use the source code after you left?
> A: No. I particularly told Mr. Conway that his company would not have the right to modify this code unless they paid me to do it.
> . . .
> Q: When you left on July 10, 1996, you had reached no agreement with Titleserv as to what your arrangement would be with respect to the modification of source code after you left, correct?
> A: We had not finalized an arrangement, that's a correct statement.

Berman Ex. C, Krause Dep. pp. 409, 414. Krause's testimony clearly indicates that there was no meeting of the minds necessary to form a binding agreement. *See Weiskopf v. American Kennel Club*, No. 00-CV-471, 2002 WL

1303022, at *7 (E.D.N.Y. June 11, 2002) (a legally enforceable agreement requires a meeting of the minds or mutual assent to the material terms of the agreement).

For the reasons stated above, the court finds that at the very least, Titleserv owned a copy of the programs. The court further concludes that the changes made to those programs by Titleserv were essential to their utilization in Titleserv's business. Therefore the modifications and/or adaptations made to those programs were permissible pursuant to 17 U.S.C. § 117 and *Aymes*. As such, there is no copyright infringement and it is recommended that summary judgment be GRANTED in favor of defendants on this ground.

B. Verbal nonexclusive license as a bar to a copyrighted infringement action

As an alternative theory in support of its motion for summary judgment, defendants argue, for purposes of this motion only, that Titleserv had a verbal nonexclusive license to use the programs, and conclude that such a license bars an action for copyright infringement. There is some confusion in the parties' papers when discussing any sort of 'license.' Krause seems to suggest that there were potentially two separate licenses—a verbal, exclusive license that covered Titleserv's use of the programs up until the day Krause left, and a second license that would have covered the relationship between the parties after Krause left. As discussed above, there was no license as a matter of law between the parties as to the verbal, exclusive license alleged by Krause. The post-departure license may have been negotiated between the parties but was never entered into, and Krause refers to it in his papers as the one rejected by Titleserv. Aneser Ex. 14, Krause Aff. ¶ 18;

Aneser Ex. 15, Krause Aff. ¶26. Although Titleserv adopts the existence of some license as an alternative theory in support of this motion, defendants' basic position is that there was no licensing agreement of any kind. Thus both parties agree that no such agreement was reached. As there was no licensing agreement, summary judgment is not appropriate on this theory.

C. Plaintiff's failure to establish copyright infringement

To prevail on a claim of copyright infringement, "a plaintiff must show both ownership of a valid copyright and that the defendant copied protectable elements of the copyrighted work." *Harbor Software, Inc. v. Applied Sys., Inc.*, 925 F. Supp. 1042, 1045 (S.D.N.Y. 1996) (citing *Feist Publ'ns, Inc. v. Rural Tel. Serv. Co.*, 499 U.S. 340, 361 (1991); *Computer Assocs. Int'l, Inc. v. Altai, Inc.*, 982 F.2d 693, 701 (2d Cir. (1992)). For purposes of this motion only, defendants argue that even if Krause is found to be the owner of the copyrights at issue, he has not shown that defendants copied protectable elements of the copyrighted works and thus summary judgment should be granted in favor of defendants.[9]

To support their argument, defendants rely on the testimony of plaintiff's expert, Tina Newton, in which she states that she "didn't see anything copied." Aneser Ex. 9, Newton Dep. pp. 91 & 99. Defendants apparently did not

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[9] Although plaintiff is correct in pointing out that the Defendants' Local Rule 56.1 Statement contains no undisputed facts in support of defendants' argument, that is not a bar to the court's consideration of the issue. *See Holtz v. Rockefeller & Co.*, 258 F.3d 62, 73 (2d Cir. 2001) (district court has discretion to review the record beyond Local Rule 56.1 statements).

further explore what Dr. Newton meant by "copied." Plaintiff contends that Newton used this word as a layperson, and that the word has a different meaning in copyright law. Plaintiff notes that "[t]he word 'copying' is shorthand for the infringing of any of the copyright owner's five exclusive rights, described at 17 U.S.C. 106." *S.O.S. Inc. v. Payday, Inc.*, 886 F.2d 1081, 1085 n.3 (2d Cir. 1989). The court agrees that Dr. Newton's meaning is unclear and finds that this single statement is too slender a reed to provide the basis for granting summary judgment.

Defendants have provided reports from two expert witnesses. Aneser Ex. 6, Keohane Report; Aneser Ex. 7, Weiser Report. The court also has Dr. Newton's expert report. Aneser Ex. 5, Newton Report. The court has reviewed all the reports and notes that, not surprisingly, they differ as to a conclusion regarding the extent to which, if any, the new programs were copied or derived from the old programs. As such, the question comes down to which expert to believe. "The credibility of competing expert witnesses is a matter for the jury, and not a matter to be decided on summary judgment." *Scanner Technologies Corp. v. ICOS Vision Sys. Corp.*, 253 F. Supp.2d 624, 634 (S.D.N.Y. 2003) (citing *Anderson v. Liberty Lobby*, 477 U.S. 242, 255 (1986); *Lucente v. Int'l Bus. Mach., Inc.*, 310 F.3d 243, 254 (2d Cir. 2002)). Accordingly, the court declines to make such a determination.

There is some concern that should this case go to trial, defendants will be hard-pressed to mount a defense when plaintiff has not indicated what protectable elements of the programs were infringed. Entry of summary judgment, however, is not an appropriate way to address that concern. *See Fonar Corp. v. Domenick*, 105 F.3d 99, 103 (2d Cir. 1997). As there are issues of material fact, the

court finds that summary judgment is not appropriate on this theory.

II. Defendants' Cross-Motion for Sanctions:

In response to plaintiff's motion for a default judgment pursuant to Rule 37, defendants cross-moved for sanctions pursuant the court's inherent power and to 28 U.S.C. § 1927. The undersigned recommended that plaintiff's Rule 37 motion be denied, and that recommendation was adopted by Judge Platt in an order dated August 15, 2002. Defendants have renewed their cross-motion for sanctions based in part upon the undersigned's report and recommendation.

Although the court characterized plaintiff's Rule 37 motion as a "tactical decision," it declines to follow the suggestion that the motion must, by necessity, be sanctionable. Therefore it is recommended that defendants' cross-motion for sanctions be DENIED.

CONCLUSION

It is respectfully recommended that Titleserv's motion for summary judgment be GRANTED on the ground that any modifications to the programs were allowed pursuant to 17 U.S.C. § 117, and that Titleserv's motion for sanctions be DENIED.

OBJECTIONS

A copy of the Report and Recommendation is being sent by the Court to all parties. Any objections to this Report and Recommendation must be filed with the Clerk of the Court with a courtesy copy to the undersigned within 10 days of service. Failure to file objections within this

period waives the right to appeal the District Court's Order. *See* 28 U.S.C. § 636(b)(1); Fed. R. Civ. P. 72; *Beverly v. Walker*, 118 F.3d 900, 902 (2d Cir. 1997); *Savoie v. Merchants Bank*, 84 F.3d 52, 60 (2d Cir. 1996).

Dated: Central Islip, New York
August 7, 2003

/s/ WILLIAM D. WALL
William D. Wall
United States Magistrate Judge

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
Thurgood Marshall U.S. Court House
40 Foley Square
New York 10007

Roseann B. MacKechnie
CLERK

[Round Stamp]
FILED
MAY 03 2005

Date: 5/3/05
Docket Number: 03-9303-cv
Short Title: Krause v. Titleserv, Inc.
DC Docket Number: 98-cv-5756
DC: EDNY/CINY
DC Judge:

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the Thurgood Marshall United States Courthouse, Foley Square, in the City of New York, on the 3rd day of May two thousand five.

Present:

Hon. Pierre N. Leval
Hon. Robert A. Katzmann

CIRCUIT JUDGES,

WILLIAM KRAUSE dba Special-T software,

Plaintiff-Appellant,

v.

TITLESERV, INC., NEW YORK SETTLEMENT CORP., DAVID EISENBERG, KENNETH WODISKA, THOMAS MURPHY and JAMES J. CONWAY, III,

Defendants-Appellees.

A petition for panel rehearing having been filed herein by William Krause

Upon consideration thereof, it is

Ordered that said petition be and it hereby is **DENIED**.

For the Court,
Roseann B. MacKechnie, Clerk

By: /s/ ARTHUR HELLER
Motion Staff Attorney

APPENDIX E

SELECTED PROVISIONS OF THE COPYRIGHT ACT OF 1976

17 U.S.C. § 101 states, in pertinent part:

Except as otherwise provided in this title, as used in this title, the following terms and their variant forms mean the following:

* * *

A "computer program" is a set of statements or instructions to be used directly or indirectly in a computer in order to bring about a certain result.

"Copies" are material objects, other than phonorecords, in which a work is fixed by any method now known or later developed, and from which the work can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or device. The term "copies" includes the material object, other than a phonorecord, in which the work is first fixed.

* * *

A "device", "machine", or "process" is one now known or later developed.

17 U.S.C. § 106 provides:

Subject to sections 107 through 122, the owner of copyright under this title has the exclusive rights to do and to authorize any of the following:

(1) to reproduce the copyrighted work in copies or phonorecords;

(2) to prepare derivative works based upon the copyrighted work;

(3) to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending;

(4) in the case of literary, musical, dramatic, and choreographic works, pantomimes, and motion pictures and other audiovisual works, to perform the copyrighted work publicly;

(5) in the case of literary, musical, dramatic, and choreographic works, pantomimes, and pictorial, graphic, or sculptural works, including the individual images of a motion picture or other audiovisual work, to display the copyrighted work publicly; and

(6) in the case of sound recordings, to perform the copyrighted work publicly by means of a digital audio transmission.

17 U.S.C. § 109 provides:

(a) Notwithstanding the provisions of section 106(3), the owner of a particular copy or phonorecord lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord. Notwithstanding the preceding sentence, copies or phonorecords of works sub-

ject to restored copyright under section 104A that are manufactured before the date of restoration of copyright or, with respect to reliance parties, before publication or service of notice under section 104A(e), may be sold or otherwise disposed of without the authorization of the owner of the restored copyright for purposes of direct or indirect commercial advantage only during the 12-month period beginning on—

(1) the date of the publication in the Federal Register of the notice of intent filed with the Copyright Office under section 104A(d)(2)(A), or

(2) the date of the receipt of actual notice served under section 104A(d)(2)(B), whichever occurs first.

(b)(1)(A) Notwithstanding the provisions of subsection (a), unless authorized by the owners of copyright in the sound recording or the owner of copyright in a computer program (including any tape, disk, or other medium embodying such program), and in the case of a sound recording in the musical works embodied therein, neither the owner of a particular phonorecord nor any person in possession of a particular copy of a computer program (including any tape, disk, or other medium embodying such program), may, for the purposes of direct or indirect commercial advantage, dispose of, or authorize the disposal of, the possession of that phonorecord or computer program (including any tape, disk, or other medium embodying such program) by rental, lease, or lending, or

by any other act or practice in the nature of rental, lease, or lending. Nothing in the preceding sentence shall apply to the rental, lease, or lending of a phonorecord for nonprofit purposes by a nonprofit library or nonprofit educational institution. The transfer of possession of a lawfully made copy of a computer program by a nonprofit educational institution to another nonprofit educational institution or to faculty, staff, and students does not constitute rental, lease, or lending for direct or indirect commercial purposes under this subsection.

(B) This subsection does not apply to—

(i) a computer program which is embodied in a machine or product and which cannot be copied during the ordinary operation or use of the machine or product; or

(ii) a computer program embodied in or used in conjunction with a limited purpose computer that is designed for playing video games and may be designed for other purposes.

(C) Nothing in this subsection affects any provision of chapter 9 of this title.

(2)(A) Nothing in this subsection shall apply to the lending of a computer program for nonprofit purposes by a nonprofit library, if each copy of a computer program which is lent by such library has affixed to the packaging containing the program a warning of copyright in accordance with requirements that the Register of Copyrights shall prescribe by regulation.

(B) Not later than three years after the date of the enactment of the Computer Software Rental Amendments Act of 1990, and at such times thereafter as the Register of Copyrights considers appropriate, the Register of Copyrights, after consultation with representatives of copyright owners and librarians, shall submit to the Congress a report stating whether this paragraph has achieved its intended purpose of maintaining the integrity of the copyright system while providing nonprofit libraries the capability to fulfill their function. Such report shall advise the Congress as to any information or recommendations that the Register of Copyrights considers necessary to carry out the purposes of this subsection.

(3) Nothing in this subsection shall affect any provision of the antitrust laws. For purposes of the preceding sentence, "antitrust laws" has the meaning given that term in the first section of the Clayton Act and includes section 5 of the Federal Trade Commission Act to the extent that section relates to unfair methods of competition.

(4) Any person who distributes a phonorecord or a copy of a computer program (including any tape, disk, or other medium embodying such program) in violation of paragraph (1) is an infringer of copyright under section 501 of this title and is subject to the remedies set forth in sections 502, 503, 504, 505, and 509. Such violation shall not be a criminal offense under section 506 or cause such person to be subject to the criminal penalties set forth in section 2319 of title 18.

(c) Notwithstanding the provisions of section 106(5), the owner of a particular copy lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to display that copy publicly, either directly or by the projection of no more than one image at a time, to viewers present at the place where the copy is located.

(d) The privileges prescribed by subsections (a) and (c) do not, unless authorized by the copyright owner, extend to any person who has acquired possession of the copy or phonorecord from the copyright owner, by rental, lease, loan, or otherwise, without acquiring ownership of it.

(e) Notwithstanding the provisions of sections 106(4) and 106(5), in the case of an electronic audiovisual game intended for use in coin-operated equipment, the owner of a particular copy of such a game lawfully made under this title, is entitled, without the authority of the copyright owner of the game, to publicly perform or display that game in coin-operated equipment, except that this subsection shall not apply to any work of authorship embodied in the audiovisual game if the copyright owner of the electronic audiovisual game is not also the copyright owner of the work of authorship.

17 U.S.C. § 117 provides:

(a) Making of additional copy or adaptation by owner of copy.—Notwithstanding the provisions of section 106, it is not an infringement for the

owner of a copy of a computer program to make or authorize the making of another copy or adaptation of that computer program provided:

(1) that such a new copy or adaptation is created as an essential step in the utilization of the computer program in conjunction with a machine and that it is used in no other manner, or

(2) that such new copy or adaptation is for archival purposes only and that all archival copies are destroyed in the event that continued possession of the computer program should cease to be rightful.

(b) Lease, sale, or other transfer of additional copy or adaptation.—Any exact copies prepared in accordance with the provisions of this section may be leased, sold, or otherwise transferred, along with the copy from which such copies were prepared, only as part of the lease, sale, or other transfer of all rights in the program. Adaptations so prepared may be transferred only with the authorization of the copyright owner.

(c) Machine maintenance or repair.—Notwithstanding the provisions of section 106, it is not an infringement for the owner or lessee of a machine to make or authorize the making of a copy of a computer program if such copy is made solely by virtue of the activation of a machine that lawfully contains an authorized copy of the computer program, for purposes only of maintenance or repair of that machine, if—

(1) such new copy is used in no other manner and is destroyed immediately after the maintenance or repair is completed; and

(2) with respect to any computer program or part thereof that is not necessary for that machine to be activated, such program or part thereof is not accessed or used other than to make such new copy by virtue of the activation of the machine.

(d) Definitions.—For purposes of this section—

(1) the "maintenance" of a machine is the servicing of the machine in order to make it work in accordance with its original specifications and any changes to those specifications authorized for that machine; and

(2) the "repair" of a machine is the restoring of the machine to the state of working in accordance with its original specifications and any changes to those specifications authorized for that machine.

17 U.S.C. § 201(a) provides:

Copyright in a work protected under this title vests initially in the author or authors of the work. The authors of a joint work are coowners of copyright in the work.

17 U.S.C. § 202 provides:

Ownership of a copyright, or of any of the exclusive rights under a copyright, is distinct from ownership of any material object in which the work is embodied. Transfer of ownership

of any material object, including the copy or phonorecord in which the work is first fixed, does not of itself convey any rights in the copyrighted work embodied in the object; nor, in the absence of an agreement, does transfer of ownership of a copyright or of any exclusive rights under a copyright convey property rights in any material object.

APPENDIX F

Excerpt From:

Final Report of the National Commission on New Technological Uses of Copyrighted Works, July 31, 1978 (Library of Congress, Washington, D.C. 1979), pages 9-14.

CHAPTER 3
Computers and Copyright

In creating the Commission, Congress directed that two broad subjects concerning computers and copyright be addressed: the creation of new works with computer assistance and the use of copyrighted works in conjunction with computers. With respect to the second area, the Commission has considered three separate issues: the placement into computers of any copyrighted works, the use of automated data bases, and copyright protection for the intellectual property in computer programs.

Because this study was to be undertaken, Congress included a section in the new copyright law specifying that a copyright owner had the same rights with respect to computer uses of copyrighted works as were available under the copyright law before the effective date of the Act of 1976– existing state statutes, case law, and the provisions of the Copyright Act of 1909.[36] The legislative history of the 1976 Act clearly shows that Congress intended that the provision be continued, eliminated, or modified, based upon the Commission's recommendations.[37]

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[36] 17 U.S.C. § 117.

[37] House Report, *supra* note 1, p. 116.

Background

From the Renaissance through the Industrial Revolution to the present, technological developments have consistently extended society's power to control natural phenomena and to shape its own destiny. The rapid developments in communications and information technology of the past three decades have immeasurably expanded and extended the power of human communication.

One of the most important contributions to the communication and information revolution has been the digital computer. Animated by elements of human creative genius, these machines are opening new avenues for recording, storing, and transmitting human thought. New means of communication transcend words fixed on paper or images on film and permit authors to communicate creatively, adaptively, and dynamically with their audience.

The first commercial computers, built shortly after World War II, were based largely on vacuum tubes and were so expensive that only the government or the largest corporations could even consider owning them. To function, the typical early computer required an environment in which temperature and humidity were carefully monitored. It was controlled by programs created by its manufacturer and users exclusively for that particular computer.

Subsequent generations of computers have been characterized by dramatic reductions in the size, energy requirements, and price for a given amount of computational power. These generations are measured by the changes in the electronic circuitry of the computer. The four generations now generally acknowledged have been based upon vacuum tubes, transistors, printed circuits, and integrated circuits, respectively.

Foundation for the Recommendations

Computer Programs[38]

Computer programs are a form of writing virtually unknown twenty-five years ago. They consist of sets of instructions which, when properly drafted, are used in an almost limitless number of ways to release human beings from such diverse mundane tasks as preparing payrolls, monitoring aircraft instruments, taking data readings, making calculations for research, setting type, operating assembly lines, and taking inventory. Computer programs are prepared by the careful fixation of words, phrases, numbers, and other symbols in various media. The instructions that make up a program may be read, understood, and followed by a human being. For both economic and humanitarian reasons, it is undesirable for people to carry out manually the process described in painstaking detail in a computer program. Machines, lacking human attributes, cannot object to carrying out repetitious, boring, and tedious tasks. Because machines can and do perform these tasks, people are free to do those other things which they alone can do or in which they find a more rewarding expenditure of their efforts.

Great changes have occurred in the construction of computers, as well as in the media in which programs are recorded. Periodic progress has seen the development, utilization, and, in some cases, passage into obsolescence of bulky plug boards, punched paper cards and tape, magnetic tapes and disks, and semiconductor chips. It should be emphasized that these developments reflect differences

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[38] Separate opinions by Commissioners Nimmer, Hersey, and Karpatkin follow in this chapter.

only in the media in which programs are stored and not in the nature of the programs themselves.

The evolution of these media is similar to that of devices for playing recorded music. Circuit boards may be compared to music boxes, and punched paper to piano rolls, while magnetic disks and tapes store music and programs in precisely the same manner. Both recorded music and computer programs are sets of information in a form which, when passed over a magnetized head, cause minute currents to flow in such a way that desired physical work is accomplished.

The need for protecting the form of expression chosen by the author of a computer program has grown proportionally with two related concurrent trends. Computers have become less cumbersome and expensive, so that individuals can and do own computers in their homes and offices with more power than the first commercial computers, while at the same time, programs have become less and less frequently written to comply with the requirements imposed by a single-purpose machine.

Just as there was little need to protect the ridged brass wheel in a nineteenth-century music box, so too was there little reason to protect the wired circuit or plug boards of early computers. The cost of making the wheel was inseparable from the cost of producing the ridged final product. The cost of copying a reel of magnetic tape, whether it contains a Chopin etude or a computer program, is small. Thus, the following proposition seems sound: if the cost of duplicating information is small, then it is simple for a less than scrupulous person to duplicate it. This means that legal as well as physical protection for the information is a necessary incentive if such information is to be created and disseminated.

This proposition is the underlying principle of copyright, but from 1908 until early 1972 the copyright laws of the United States did not reflect its acceptance with respect to one form of expression: recorded sounds. Because the Supreme Court held in 1908 that since a piano roll was not readily perceptible to human eyes it was not a copy of the music it rendered on a player piano, there was almost "open season"—at least in terms of federal law—on the duplication of piano rolls, shellac and vinyl records, and audio tape recordings.[39] Certain states made it illegal to duplicate such works, but federal copyright remained almost powerless in this area. While this rule was often criticized, its effect was apparently not too deleterious to producers of recorded sounds, so long as the cost of disk duplication made commercial piracy an expensive undertaking. Records and piano rolls were doubtless duplicated and sold, but on a less than threatening scale. The development of inexpensive transistorized tape recording equipment and its use by organized pirates posed serious economic problems for either the 1908 rule or the recording industry. But the principle persevered and finally prevailed in the Sound Recording Act of 1971, which provided sanctions against those who engage in the unauthorized duplication of sound recordings.[40]

As the number of computers has increased dramatically, so has the number of programs with which they may be used. While the first computers were designed and programmed to perform one or a few specific tasks, an ever increasing proportion of all computers are general purpose machines which perform diverse tasks, depending in part

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[39] White-Smith Music Pub. Co. v. Apollo Co.; 209 U.S. 1 (1908).

[40] P.L. 92-140, 85 Stat. 391 (1971).

upon the programs with which they are used. Early programs were designed by machine manufacturers to be used in conjunction with one model or even one individual computer. Today, many programs are designed to operate on any number of machines from one or more manufacturers. In addition, and perhaps even more importantly, there is a growing proportion of programs created by persons who I [*sic*] do not make machines. These people may be users or they may be—and increasingly are—programmers or small firms who market their wares for use by individual machine owners who are not in a position to write their own programs. Just as Victrola once made most of the first record players and records, so too did early machine manufacturers write most of the first programs. Victrola's successor, RCA, still produces sound recordings (but, interestingly enough, not phonographs), but so do hundreds of other firms. If present computer industry trends continue, it is all but certain that programs written by non-machine manufacturers will gain an increasing share of the market, not only because writing programs and building machines are two very different skills that need not necessarily occur simultaneously, but also because program writing requires little capital investment.[41]

The cost of developing computer programs is far greater than the cost of their duplication. Consequently, computer programs, as the previous discussion illustrates, are likely to be disseminated only if:

1. the creator may recover all of its costs plus a fair profit on the first sale of the work, thus leaving it unconcerned about the later publication of the work; or

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[41] For a discussion of barriers to entry in the hardware and software markets, see this chapter under Economic Effects of Program Copyright.

2. the creator may spread its costs over multiple copies of the work with some form of protection against unauthorized duplication of the work; or

3. the creator's costs are borne by another, as, for example, when the government or a foundation offers prizes or awards; or

4. the creator is indifferent to cost and donates the work to the public.

The consequence of the first possibility would be that the price of virtually any program would be so high that there would necessarily be a drastic reduction in the number of programs marketed. In this country, possibilities three and four occur, but rarely outside of academic and government-sponsored research. Computer programs are the product of great intellectual effort and their utility is unquestionable. The Commission is, therefore, satisfied that some form of protection is necessary to encourage the creation and broad distribution of computer programs in a competitive market.

The Commission's conclusion is that the continued availability of copyright protection for computer programs is desirable.[42] This availability is in keeping with nearly two centuries' development of American copyright doctrine, during which the universe of works protectible [sic] by statutory copyright has expanded along with the imagination, communications media, and technical capabilities of society.

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[42] The Copyright Office presently accepts computer programs for registration. (See this chapter under Statutory Copyrightability of Programs and Appendix A under Eighty-eighth Congress, 1964 Revision Bill.)

This conclusion is in accord with the recommendations of groups studying this issue for the United Kingdom and the World Intellectual Property Organization.[43] Both studies recommended that computer programs be afforded protection to a degree that is virtually identical to American copyright.[44] A Canadian study reached the opposite conclusion, and an Australian report considered computer issues outside its terms of reference.[45]

The Commission also believes that the effects of the recommendations pertaining to computer programs made in this report, as well as those pertaining to the other computer-related subjects within the Commission's jurisdiction, should be periodically reviewed. This could be accomplished on a smaller scale than that undertaken by the Commission but should be performed well and often enough to prevent the copyright law from becoming as anachronistic as did the 1909 Act.

The Commission is unanimous in its belief that computer programs are entitled to legal protection. But the

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[43] *Copyright and Designs Law: Report of the Committee to Consider the Law on Copyright and Designs* (H.M.S.O., 1976) (frequently known as the Whitford Committee Report); *Model Provisions on the Protection of Computer Software* (1978).

[44] A recent study for the World Intellectual Property Organization (WIPO) notes that "in a number of countries it would already be possible to give such protection [to programs] on the basis of current legislation on copyright... and consequently special legislation would not be necessary. In various countries including the United States... there would seem to be no particular desire to set up special provisions to protect software" (Kolle, *Computer Software Protection– Present Situation and Future Prospects*, 1977 COPYRIGHT 72).

[45] Keyes and Brunet, *Copyright in Canada: Proposals for a Revision of the Law* (1977); *Report of the Copyright Law Committee on Reprographic Reproduction* (1976).

unanimity has not extended to the precise form that protection should take.[46] The law as it exists today with respect to the protection of computer programs is not totally clear. What is clear is that today there are different and often conflicting methods used by proprietors to attempt to protect their products. These include patent and copyright—exclusively federal statutory methods; trade secret law—derived from statutory and judicial state law; and unfair competition-based on elements of common law and federal statute.[47]

To provide reasonable protection for proprietors without unduly burdening users of programs and the general public, the following statements concerning program copyright ought to be true:

1. Copyright should proscribe the unauthorized copying of these works.

2. Copyright should in no way inhibit the rightful use of these works.

3. Copyright should not block the development and dissemination of these works.

4. Copyright should not grant anyone more economic power than is necessary to achieve the incentive to create.

Relatively few changes in the Copyright Act of 1976 are required to attain these objectives, and the promulgation of regulations by the Copyright Office will ease the burden of compliance for both copyright owners and users.

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[46] See this chapter for the separate opinions of Commissioners Nimmer, Hersey, and Karpatkin.

[47] See this chapter under Copyright and Other Methods Compared.

Recommendations for Statutory Change

To make the law clear regarding both proprietors' and users' rights, the Commission suggests that the following changes to the Copyright Act of 1976 be made:

1. That section 117 as enacted be repealed.

2. That section 101 be amended to add the following definition:

> A "computer program" is a set of statements or instructions to be used directly or indirectly in a computer in order to bring about a certain result.

3. That a new section 117 be enacted as follows:

> § 117: Limitations on exclusive rights: computer programs
>
> Notwithstanding the provisions of § 106, it is not an infringement for the rightful possessor of a copy of a computer program to make or authorize the making of another copy or adaptation of that computer program provided:
>
> > (1) that such a new copy or adaptation is created as an essential step in the utilization of the computer program in conjunction with a machine and that it is used [*sic*] no other manner, or
> >
> > (2) that such new copy or adaptation is for archival purposes only and that all archival copies are destroyed in the event that continued possession of the computer program should cease to be rightful.

> Any exact copies prepared in accordance with the provisions of this section may be leased, sold, or otherwise transferred, along with the copy from which such copies were prepared, only as part of the lease, sale, or other transfer of all rights in the program. Adaptations so prepared may be transferred only with the authorization of the copyright owner.

The 1976 Act, without change, makes it clear that the placement of any copyrighted work into a computer is the preparation of a copy and, therefore, a potential infringement of copyright. Section 117, designed to subject computer uses of copyrighted works to treatment under the old law, vitiates that proscription, at least insofar as machine-readable versions are not *copies* under the 1909 Act.[48] Therefore, to prevent any question concerning the impropriety of program piracy and to assure that all works of authorship are treated comparably under the new law, section 117 should be repealed.[49]

Because the placement of a work into a computer is the preparation of a copy, the law should provide that persons in rightful possession of copies of programs be able to use them freely without fear of exposure to copyright liability. Obviously, creators, lessors, licensors, and vendors of copies of programs intend that they be used by their cus-

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[48] If they are not, then their unauthorized duplication would not be an infringement, just as the unauthorized duplication of sound recordings was largely without the scope of copyright before February 15, 1972. (See this chapter under Computer Programs.)

[49] This appears consistent with congressional intent that section 117 should only be effective pending the Commission's report. (See House Report, *supra* note 1, p. 116.)

tomers, so that rightful users would but rarely need a legal shield against potential copyright problems. It is easy to imagine, however, a situation in which the copyright owner might desire, for good reason or none at all, to force a lawful owner or possessor of a copy to stop using a particular program. One who rightfully possesses a copy of a program, therefore, should be provided with a legal right to copy it to that extent which will permit its use by that possessor. This would include the right to load it into a computer and to prepare archival copies of it to guard against destruction or damage by mechanical or electrical failure. But this permission would not extend to other copies of the program. Thus, one could not, for example, make archival copies of a program and later sell some while retaining some for use. The sale of a copy of a program by a rightful possessor to another must be of all rights in the program, thus creating a new rightful possessor and destroying that status as regards the seller. This is in accord with the intent of that portion of the law which provides that owners of authorized copies of a copyrighted work may sell those copies without leave of the copyright proprietor.[50]

Because of a lack of complete standardization among programming languages and hardware in the computer industry, one who rightfully acquires a copy of a program frequently cannot use it without adapting it to that limited extent which will allow its use in the possessor's computer. The copyright law, which grants to copyright proprietors the exclusive right to prepare translations, transformations, and adaptations of their work, should no more prevent such use than it should prevent rightful possessors from loading programs into their computers.[51] Thus, a right to

[50] 17 U.S.C. § 109(a).

[51] 17 U.S.C. §§ 101 and 106(2).

make those changes necessary to enable the use for which it was both sold and purchased should be provided. The conversion of a program from one higher-level language to another to facilitate use would fall within this right, as would the right to add features to the program that were not present at the time of rightful acquisition. These rights would necessarily be more private in nature than the right to load a program by copying it and could only be exercised so long as they did not harm the interests of the copyright proprietor. Unlike the exact copies authorized as described above, this right of adaptation could not be conveyed to others along with the licensed or owned program without the express authorization of the owner of the copyright in the original work. Preparation of adaptations could not, of course, deprive the original proprietor of copyright in the underlying work.[52] The adaptor could not vend the adapted program, under the proposed revision of the new law,[53] nor could it be sold as the original without the author's permission.[54] Again, it is likely that many transactions involving copies of programs are entered into with full awareness that users will modify their copies to suit their own needs, and this should be reflected in the law. The comparison of this practice to extensive marginal note-taking in a book is appropriate: note-taking is arguably the creation of a derivative work, but unless the note-taker tries to copy and vend that work, the copyright owner is

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[52] Grove Press, Inc., v. Greenleaf Publishing Co., 247 F.Supp. 127 (E.D.N.Y. 1965).

[53] See this chapter under Recommendations for Statutory Change.

[54] 17 U.S.C. § 106(2) and Gilliam v. American Broadcasting Co., 192 U.S.P.Q. 1 (2d Cir. 1976).

unlikely to be very concerned. Should proprietors feel strongly that they do not want rightful possessors of copies of their programs to prepare such adaptations, they could, of course, make such desires a contractual matter.

APPENDIX G

BLACK'S LAW DICTIONARY DEFINITIONS OF STATUTORY LANGUAGE "ESSENTIAL" THAT THE SECOND CIRCUIT FAILED TO CONSIDER

> **ESSENTIAL.** Indispensably necessary; important in the highest degree; requisite. Solter v. Macmillan, 147 Md. 580, 128 A. 356, 358; City of Kalamazoo v. Balkema, 252 Mich. 308, 233 N.W. 325, 326.

Black's Law Dictionary 642 (Revised 4th ed. 1968).

> **Essential.** Indispensably necessary; important in the highest degree; requisite. That which is required for the continued existence of a thing.

Black's Law Dictionary 490 (5th ed. 1979).

APPENDIX H

BLACK'S LAW DICTIONARY DEFINITIONS OF "NECESSARY" THAT THE SECOND CIRCUIT RELIED ON AS A SUBSTITUTE FOR "ESSENTIAL"

NECESSARY. This word must be considered in the connection in which it is used, as it is a word susceptible of various meanings. It may import absolute physical necessity or inevitability, or it may import that which is only convenient, useful, appropriate, suitable, proper, or conducive to the end sought. It is an adjective expressing degrees, and may express mere convenience or that which is indispensable or an absolute physical necessity. It may mean something which in the accomplishment of a given object cannot be dispensed with, or it may mean something reasonably useful and proper, and of greater or lesser benefit or convenience, and its force and meaning must be determined with relation to the particular object sought. Kay County Excise Board v. Atchison, T. & S. F. R. Co., 185 Okl. 327, 91 P.2d 1087, 1088.

In eminent domain proceedings, it means land reasonably requisite and proper for accomplishment of end in view, not absolute necessity of particular location. State v. Whitcomb, 94 Mont. 415, 22 P.2d 823.

As to necessary "Damages," "Deposit," "Domicile," "Implication," "Intromission," "Parties," "Repairs," and "Way," see those titles.

Black's Law Dictionary 1181-82 (Revised 4th ed. 1968).

Necessary. This word must be considered in the connection in which it is used, as it is a word susceptible of various meanings. It may import absolute physical necessity or inevitability, or it may import that which is only convenient, useful, appropriate, suitable, proper, or conducive to the end sought. It is an adjective expressing degrees, and may express mere convenience or that which is indispensable or an absolute physical necessity. It may mean something which in the accomplishment of a given object cannot be dispensed with, or it may mean something reasonably useful and proper, and of greater or lesser benefit or convenience, and its force and meaning must be determined with relation to the particular object sought. Kay County Excise Board v. Atchison, T. & S. F. R. Co., 185 Okl. 327, 91 P.2d 1087, 1088.

In eminent domain proceedings, it means land reasonably requisite and proper for accomplishment of end in view, not absolute necessity of particular location. State v. Whitcomb, 94 Mont. 415, 22 P.2d 823.

With respect to taxation, means appropriate and helpful in furthering the taxpayer's business or income producing activity. I.R.C. §§ 162(a) and 212. See also **Ordinary.**

As to necessary Damages; Deposit; Domicile; Implication; Intromission; Repairs; and Way, see those titles. See also **Necessaries; Necessity.**

Black's Law Dictionary 928 (5th ed. 1979).

Supreme Court, U.S.
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No. 05-166

IN THE

Supreme Court of the United States

WILLIAM KRAUSE dba SPECIAL-T SOFTWARE,

Petitioner,

v.

TITLESERV, INC., NEW YORK SETTLEMENT CORP., DAVID EISENBERG, KENNETH WODISKA, THOMAS MURPHY and JAMES J. CONWAY, III,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether this Court should review the Second Circuit's and the district court's determination that, upon the specifics facts of this case, Titleserv, Inc. was an owner of the computer programs at issue pursuant to 17 U.S.C. § 117.

2. Whether the court of appeals and the district court correctly held that, under the specific facts of this case, defendants' modification of the programs at issue was 'an essential step in the utilization of the computer program[s] in conjunction with a machine' pursuant to 17 U.S.C. § 117.

RULE 29.6 STATEMENT

Titleserv, Inc. and New York Settlement Corp. are each privately held companies owed by a single shareholder and neither corporation has a parent company nor any non-wholly-owned subsidiaries.

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17 U.S.C. § 204 13

Other Authorities:

2 Melville B. Nimmer, *Nimmer on Copyright* ¶ 8.08[B][1] (3d ed. 1997) 17

National Commission on New Technological Uses of Copyrighted Works ("CONTU"), Final Report, July 31, 1978 (Library of Congress, Washington D.C. 1979) 14, 22

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a to 23a) is reported at 402 F.3d 119. The district court's opinion (Pet. App. 24a to 33a) is reported at 289 F. Supp. 2d 316. The district court's report and recommendation (Pet. App. 34a to 56a) and the order of the court of appeals denying rehearing (Pet. App. 57a to 58a) are unreported.

JURISDICTION

The court of appeals entered its judgment on March 21, 2005, and denied petitioner's petition for rehearing on May 3, 2005. Petitioner's petition for a writ of certiorari was filed on August 1, 2005 and placed on the docket on August 3, 2005. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254 (1).

STATEMENT OF THE CASE

Titleserv, Inc. ("Titleserv")[1] was granted summary judgment in this copyright infringement action because a Magistrate Judge, a District Court Judge and the Second Circuit Court of Appeals all found that Titleserv owned copies of the computer programs at issue and that the modifications Titleserv made to those computer programs were permitted under 17 U.S.C. § 117(a)(1).

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1. Titleserv is the principal defendant. The other corporate defendant, New York Settlement Corp., an affiliated company, is wholly owned by same individual who owns Titleserv. The individual defendants are or were affiliated with Titleserv. Hereafter, all defendants are collectively referred to as "Titleserv."

This case does not involve any constitutional issues, nor any novel interpretations of 17 U.S.C. § 117, nor does the Second Circuit's decision below conflict with any other federal circuit decisions. Petitioner distorts and misconstrues the factual record in this case and fails to raise any certworthy issues. In fact, the best Petitioner could hope for is that the grant of summary judgment would be reversed based upon this Court finding a disputed issue of fact that should have precluded summary judgment. However, this would not result in any new finding of law but would only entitle Petitioner to have the matter remanded for a trial. In essence, Petitioner merely seeks to correct what he subjectively and incorrectly deems is an erroneous district court decision granting Titleserv summary judgment based upon the undisputed facts in the record, thereby turning this Court into yet another appellate court of appeals to review whether the record was sufficient to support the grant of summary judgment. The decision below is correct in all respects, and this case simply does not involve unsettled questions of state, federal or constitutional law nor raise any certworthy issues.

17 U.S.C. § 117, entitled " Limitation on exclusive rights: Computer programs" provides in pertinent part:

> Notwithstanding the provisions of section 106, it is not an infringement for the owner of a copy of a computer program to make or authorize the making of another copy or adaptation of that computer program provided:
>
> > (1) that such a new copy or adaptation is created as an essential step in the utilization of the computer program in conjunction with a machine and that it is used in no other manner. . . .

Applying 17 U.S.C. § 117 to the undisputed facts of this case, summary judgment in favor of Titleserv was mandated.

Titleserv is a title insurance agency which originates and services title insurance orders for various underwriters and depends heavily on computers and technology in serving its clients. Titleserv's business is providing title insurance related services, not creating or selling computer software.

Titleserv hired William Krause ("Krause" or "Petitioner"), a computer programer, in 1986 to help Titleserv develop proprietary DOS based computer programs to run its operations and service Titleserv's clients. Krause was an employee of Titleserv for ten years until he quit in 1996. Krause's services for Titleserv included creating and/or obtaining computer programs which would help Titleserv run its operations. Indeed, during his ten years with Titleserv, Krause created over 35 computer programs[2] for Titleserv and was paid in excess of $364,000 to help develop proprietary DOS based computer programs for Titleserv.

As the Second Circuit observed from the undisputed factual record:

> The eight programs at issue in this suit were designed to enable Titleserv to track and report on the status of client requests and other aspects of its operations. The programs were installed on Titleserv's computer network and were thus accessible to Titleserv employees. Pet. App. 3a.

Krause quit Titleserv on July 10, 1996 taking with him the passwords and source code to Titleserv's programs. Not surprisingly, Krause was promptly sued in state court

2. Out of the 35 computer programs Krause created for Titleserv, Krause's copyright infringement claims concerned only eight (8) of those programs.

for misappropriation of Titleserv's programs. Titleserv experienced a disruption in its business operations when its computer systems failed to operate properly because Krause had tampered with the programs before he quit. Eventually the systems were fixed and new systems were created to replace the old DOS based programs.

Incredibly, after Krause quit on July 10, 1996 and after he was sued in state court by Titleserv on or about July 18, 1996, Krause applied for and obtained certificates of copyright registration for the very same computer programs which the state court directed Krause to turn over to Titleserv. Krause perpetrated fraud by failing to advise the copyright office that the ownership of the programs he sought to copyright was being litigated at the time Krause submitted his copyright applications. Then more than two full years after he quit, Krause filed a federal copyright infringement action in September 1998 claiming that Titleserv had infringed the computer programs which the state court had already directed Krause to turn over to Titleserv.

After Krause quit, the Second Circuit observed from the undisputed factual record:

> Krause left executable versions of all eight programs at issue on Titleserv's file servers, but locked them with a command, which prevented a popular decompiler from converting the executable code back into source code. Krause told Titleserv that it was free to continue using the executable code as it existed on the day Krause left, but asserted that Titleserv had no right to modify the source code. Inability to modify the source code would have severely limited the value

> of those programs to Titleserv. Many routine functions such as the addition of a new customer or a change of a customer address could be performed only by changing the source code. In addition, changes were required to fix bugs from time to time to keep the system from crashing. Pet. App. 4a.

It was undisputed in the record below that Titleserv paid Krause substantial sums for developing the computer programs and there were no restrictions on Titleserv's right to use and modify the programs. Accordingly, Titleserv had the absolute right to use, modify, adapt or expand the computer programs to keep their business running after Krause abruptly quit. *See Aymes v. Bonelli*, 47 F.3d 23 (2d Cir. 1995).

Also noted by the Second Circuit:

> Titleserv paid Krause substantial consideration to develop the programs for its sole benefit. Krause customized the software to serve Titleserv's operations. The copies were stored on a server owned by Titleserv. Krause never reserved the right to repossess the copies used by Titleserv and agreed that Titleserv has the right to continue to possess and use the programs, forever, regardless whether its relationship with Krause terminated. Titleserv was similarly free to discard or destroy the copies at any time it wished. In our view the pertinent facts in the aggregate satisfy § 117(a)'s requirement of ownership of a copy. Pet. App. 10a-11a.